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IN THE

Supreme Court of the United States,

OCTOBER TERM, 1933.

GUY T. HELVERING, COMMISSIONER, ETC. — *Petitioner,*

vs. No. 689

INDEPENDENT LIFE INSURANCE CO.,

On writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

ROCKFORD LIFE INSURANCE CO., — *Petitioner,*

vs. No. 722

GUY T. HELVERING, COMMISSIONER, ETC.,

On writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

BRIEF FOR THE INSURANCE COMPANIES.

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STATUTES INVOLVED. Revenue Act of 1921 §§245, 42 Stat. 227, 261; Revenue Act of 1924, §245, 43 Stat. 253, 289; Revenue Act of 1928, §203, 45 Stat. 791, 842.

DATE OF JUDGMENT, etc. No. 689. *Independent Life* case, Nov. 10, 1933 (R. 48).

No. 722. *Rockford Life* case, Oct. 20, 1933 (R. 24).

NATURE OF THE CASES, RULINGS, ETC. Commissioner of Internal Revenue determined certain deficiencies in income tax for 1923 and 1924 against the Independent Life Ins. Co., and for 1929 against the Rockford Life Ins. Co.

1. The B. T. A. held that § 245(b) of the Revenue Acts of 1921 and 1924, and §203(b) of the Revenue Act of 1928 were unconstitutional, as attempting to levy a "direct" tax (without apportionment) on the "rental value" of real estate occupied by the owner itself.

2. The B. T. A. further held in No. 722 that the Rockford Life was entitled to a deduction of $1,783.02 for depreciation of its furniture and fixtures; and that it was not limited to a deduction of only $292.56 for depreciation upon only such furniture and fixtures as were *used exclusively* in what the Commissioner called the *Investment* department of its business.

3. The C. C. A. (6th) affirmed the B. T. A. in No. 689, *Independent Life* case; and the C. C. A. (7th) reversed the B. T. A. in No. 722, *Rockford Life* case.

4. Certiorari was granted in each case.

IN THE

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OCTOBER TERM, 1933

GUY T. HELVERING, Commissioner, etc., *Petitioner*

vs. No. 689

INDEPENDENT LIFE INSURANCE CO.

ROCKFORD LIFE INSURANCE CO., *Petitioner*

vs. No. 722

GUY T. HELVERING, Commissioner, etc.

On writs of Certiorari to the United States Circuit Courts of Appeals for the Sixth and Seventh Circuits.

BRIEF FOR THE INSURANCE COMPANIES.

The facts are all stipulated. There is no controversy about any fact.

The purely legal questions involved in both cases are:*

(1) Is the *"rental value"* of real estate (when *occupied* by its *owner*) "income" which can be taxed under the 16th Amendment without apportionment? Or would it be a "direct" tax on the owner's real estate itself?

(2) Whatever the rule might be as to the *fair* or *actual* "rental value", can Congress fix an *arbitrary* figure which does not even purport to approximate the true

* All page references in this Brief are to the Record in No. 689, *Independent Life* Case, unless otherwise expressly indicated.

"rental value" of the occupied space, and then declare it to be "income", subject to income taxation?

(3) If, for either reason (1) or (2), such "rental value" is *not* subject to income taxation, can an *owner* of real estate who *occupies* it for his own use, be required to include such alleged arbitrary "rental value" in his income tax return, as the price of obtaining the same deductions for taxes, expenses and depreciation, as all similar real estate owners receive, who *do not occupy* their own real estate?

B. T. A. decision.

The B. T. A. decided, *First*, that any such tax on the "rental value" of an owner's realty was a "direct" tax (R. 25-29); *Second*, that Congress could not require a real estate owner to include in his gross income, the "rental value" of the property which he did not rent to others, but occupied for his own use, as a condition of the deduction of taxes, expenses and depreciation (R. 29-31); and, *Third*, that the particular "rental value" determined by the rule prescribed by Congress, did not constitute "income" under the 16th Amendment (R. 31-33).

C. C. A. decisions.

The C. C. A. (6th) *affirmed* the B. T. A. on the last ground, towit, that the particular "rental value" prescribed by Congress for inclusion *as* "income", was *not* income within the 16th Amendment as interpreted by this Court (*Com'r* v. *Independent Life*, 67 Fed. (2d) 470; R. 51, 52).

The C. C. A. (7th), without the citation of authority, or any discussion of the nature of the tax, *reversed* the

B. T. A., and held that Congress could lawfully prescribe, as a condition of allowing deductions (taxes, expenses and depreciation), that the "owner-occupier" must include such "rental value" as a part of his income (*Com'r* v. *Lafayette Life Ins. Co.*, 67 F. (2d) 209, 212; No. 722, *Rockford Life* case (R. 23-24; 67 F. (2d) 213).

Additional Question in Rockford Life Case.

The following additional question arising under § 203(a)(7) of the Revenue Act of 1928 is involved in the *Rockford Life* case only, *i. e.*

(4) Is a life insurance company entitled to deduct depreciation on *all* its "furniture and fixtures" or is the deductible depreciation limited to *such part* of its "furniture and fixtures" as it uses in what the Commissioner styles the *"Investment"* part of its business? The B. T. A. decided for the Rockford Life (No. 722, R. 15; 27 B. T. A. 1419).

The C. C. A. (7th) *reversed* the B. T. A. (No. 722, R. 23; 67 F. (2d) 213).

Relevant Statutes.*

[Revenue Act of 1921, 42 Stat. 227, 261; Revenue Act of 1924, 43 Stat. 253, 289; Revenue Act of 1928, 45 Stat. 791, 842. Our Italics.]

Sec. 244(a) That in the case of a life insurance company the term *"gross income"* means the gross amount of income **received during the taxable year** from *interest, dividends and rents.* * * *

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* No. 722, *Rockford Life* case, involves § 203 of the Revenue Act of 1928, 45 Stat. 791, 842, but it is so nearly identical with § 245, *supra*, that it need not be set out here.

Sec. 245(a) That in the case of a life insurance company the term *"net income"* means the gross income *less*—

(1) [Tax-exempt Interest]

(2) [4% of Reserve]

(3) [Certain dividends]

(4) [Deferred dividends]

(5) [Investment Expenses]

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company. * * *

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence. * * * *.

(8) [Interest paid on indebtedness]

(9) [$2,000 exemption]

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate *owned and occupied* in whole or in part by a life insurance company unless there is included in the return of gross income the *rental value* of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

STATEMENT OF THE CASE.

1. *Independent Life's Home Office Building.* The Independent Life owned a 12-story Home Office Building with a "book value" of $460,000 for 1923, and of $494,257.97 for 1924; occupied *one* floor for its own business, and *rented out* all the remaining *eleven* floors for which it could secure tenants (R. 16).

For 1923 and 1924, it reported as income the entire rentals "received during the taxable year" from all its

tenants; and [under § 245(a) (1-8)] deducted taxes, expenses and depreciation as follows, omitting cents (R. 38-40):

	1923		1924	
GROSS INCOME [under § 244(a)]				
Interest	$19,704		$20,519	
Dividends	0		0	
Rents	73,620	$93,325	71,289	$91,809
DEDUCTIONS [under § 245(a)]				
(1) Interest	$1,948		$1,687	
(2) 4% Reserve	20,363		22,773	
(5) Investment Exp.	1,946		2,220	
(6) (7) R. E. taxes, etc.	70,005*		85,918*	
(8) Interest	8,552	$102,815	868	$113,509
NET INCOME	[*Deficit*]	$9,492	[*Deficit*]	$21,760

As the Company *deducted* $70,005 and $85,918 respectively constituting items (6) and (7) as *authorized* by § 245(a)(6), (7), the Commissioner held that the Company must, therefore, as *required* by § 245(b), *include* in its Gross Income, *not only* the $73,620 and $71,289 *rentals actually "received* during the taxable year" from all tenants (which sums it had already included in its returns of income), but the *further arbitrary sums* of $14,784 for 1923 and $34,400 for 1924 (presumed to constitute the "rental value" of the *one floor occupied* by the Company); which further arbitrary sums when added to the $73,620 and $71,289 *actual* rentals "received during the taxable year", would produce the *equally arbitrary sums* of $88,405 and $105,689 respectively as the ideal "rental value" for the entire building, so as to constitute (after deducting *actual* expenses and depreciation) a 4%

1923		1924	
*(6) Taxes	$11,147	(6) Taxes	$11,147
R. E. Expenses	51,357	R. E. Expenses	67,271
(7) Depreciation	7,500	(7) Depreciation	7,500
	$70,005		$85,918

net return on the Building's "book value", thereby fictitiously converting the foregoing *actual deficits* into small *fictitious net incomes*, to wit (omitting cents; R. 39, 40):

	1923		1924	
INCOME				
Interest		$19,704		$20,519
Actual Rentals	$73,620		$71,289	
*"Rental Value" of one floor	14,784	88,405	34,400	105,689
Alleged *Gross* Income		$108,109		$126,209
DEDUCTIONS [as before]		102,815		113,569
Alleged *Net* taxable income		$5,294		$12,739

which alleged net income (after $2,000 exemption and a trifling previous assessment), resulted in the small deficiency-taxes here in controversy, of $298.97 for 1923 and

* The Commissioner's hypothetical calculations were arrived at as follows, omitting cents (R 6-8):

First. The "book value" of the Home Office Building was $460,000 for 1923 and $494,257 for 1924. The Revenue Act required the building *as a whole* (*after* deductions for taxes, expenses and depreciation) to return, as net rental, 4% of the "book value," *i. e.*, $18,400 for 1923 and $19,770 for 1924 [§ 245(b)].

Second.	1923		1924	
Rents (actual)	$73,620		$71,289	
Expenses	70,005		85,918	
Net Income (actual)	$3,615		$14,629	[*Deficit*]
"Rental value" of one floor occupied by Independent Life	14,784	$14,784	34,400	$34,400
4% on "book value"	$18,400		$19,770	
Rents (actual)		73,620		71,289
Forced to be reported as income "received" from rents		$88,405		$105,689

Although for 1923 there was an actual net rent income of only $3,615, yet by requiring the Home Office one-floor space occupied by the company to be valued at $14,784, the *actual* $3,615 net "rent income" **was forced to be stated at $18,400.**

For 1924, [by valuing the Home Office one-floor space at

$1,115.65 for 1924—a total alleged deficiency of $1,414.62 (R. 3, 5, 16, 49).

2. *Rockford Life's Home Office Building.* The Rockford Life owned and occupied for its own use its entire Home Office Building with a book value of $77,524.21 (No. 722; R. 13). For 1929, the following $4,033.05 deductions taken on account of its Home Office Building under §203(6)(7) of the Revenue Act of 1928, were *disallowed* by the Commissioner (No. 722; R. 3-4, 10, 13).

Taxes	$1,808.03
Repairs	411.31
Depreciation	1,813.71
	$4,033.05

The Commissioner *disallowed* those $4,033.05 deductions simply because the Rockford Life had *failed* [as required by § 203(b)] *to include* in its gross income $7,134.02 as the "rental value"* of its Home Office Building wholly occupied by itself in its insurance business (No. 722; R. 7).

The Rockford Life was thus denied the right to deduct its $4,033.05 taxes, etc., solely because it would not submit to the inclusion in its Gross Income of $7,134.02* purely

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$34,400 or nearly *two and a half* times as much as for 1923], a $14,629 actual *deficit*, **was forced to be stated as a net rent income of $19,770.**

The Revenue Act's method thus made the so-called "rental value" of the one-floor, $14,784 for 1923, and nearly *two and a half times* as much for 1924, *i. e.*, $34,400. Thus, for two successive years, with no change in tax rate and with no change in conditions shown (except a small increase in "book value"), a real estate owner was required to pay, with respect to the same floor he occupied himself, an income tax of *more than twice as much* for one year (1924) as for the previous year (1923).

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* Computed as follows by § 203(b) Revenue Act of 1928:

Hypothetical "Rental Value"	$7,134.02
Expenses	4,033.05
Required result: 4% on $77,254.21 "book value" =	$3,100.97

hypothetical income,—none of which was actually received—but which was declared by the Revenue Act to be the conclusively presumed "rental value" of the space occupied by itself in its *own* building.

[For convenience, the simple facts as to the Rockford Life's "furniture and fixture" controversy will be stated in connection with the Argument on that point, p. 57, *infra*.]

3. *Explanation of method of income taxation of life insurance companies.* From 1913 to 1920, life insurance companies were taxed upon their *net income;* all premiums paid in by policyholders were included as "*gross* income"; but, on account of the nature of life insurance, Congress allowed certain large *special* deductions summarized in the margin.* (*Maryland Casualty Co. v. U. S.*, 251 U. S. 342, 346-8; Brandeis, *J.* (dissent) in *National Life Ins. Co. v. U. S.*, 277 U. S. 508, 522, 523).

The Revenue Acts of 1913, 1916, 1917, and 1918, thus recognized that, as *all premiums were included as income*, the large *special* deductions noted in the margin must be allowed, in order to exclude that which the companies (1) paid out to policyholders, or (2) were compelled to retain as legal "Reserve" to meet future death losses as they should occur. This was so, on exactly the same theory

* The special deductions so allowed (1913-1920) were, to wit: (1) the net addition required by law to be made within the taxable year to Reserve funds; (2) sums other than dividends paid within the taxable year on policy and annuity contracts; and (3) in the 1918 Revenue Act, such portion of any actual premium received from any individual policyholder as is paid back or credited to, or treated as, an abatement of premium of such policyholder within the taxable year (Act Oct. 3, 1913, Section II G(b), 38 Stat. 172-3; Revenue Act of 1916, § 12(a), 39 Stat. 767-8; Revenue Act of 1917, 40 Stat. 302-305; Revenue Act of 1918, §§ 233(a)(1), 234(a)10, 40 Stat. 1077, 1079; Compare Act August 5, 1909, § 38, 36 Stat. 113).

that if a State (or Congress) includes in a bank's income or taxable assets *all the money deposited in the bank by its depositors during the year,* it must either (*a*) make the tax infinitesimally small or (*b*) allow as a deduction all the checks drawn by depositors during the year, plus the amount owing to depositors at the end of the year.* In the *National Life* case Solicitor General MITCHELL expressly so conceded, aptly saying that premiums

"*are no more income to the company* than are *deposits* in a bank *income to the bank*" (Government's Brief, p. 12). Otherwise, both the banking and insurance businesses would be taxed out of existence.

That erroneous treatment (1913-1920) of premium receipts, with corresponding special deductions, had been productive of administrative difficulties and some litigation (*McCoach* v. *Insurance Co. of N. Amer.*, 244 U. S. 585; *Maryland Cas. Co.* v. *U. S.*, 251 U. S. 342; *U. S.* v. *Boston Ins. Co.*, 269 U. S. 197; *New York Life Ins. Co.* v. *Edwards*, 271 U. S. 109; *Duffy* v. *Mutual Benefit Co.*, 272 U. S. 613; BRANDEIS, *J.*, in *National Life* case, 277 U. S. at 523).

Revenue Act of 1921.

The 1921 Revenue Act (1) simplified the taxation of life companies, and (2) deprived them of any benefit from holding tax-exempt bonds [(2) was declared unconstitutional in *National Life* v. *U. S.*, 277 U. S. 508]. This

* Cf. *Deposit Bank of Owensboro* v. *Daviess County*, 102 Ky. 174 at 214; *Com.* v. *Bank of Commerce*, 118 Ky. 547, 551-556; *Com.* v. *Wathen*, 126 Ky. 573, 574; *Branch* v. *Town of Marengo*, 43 Ia. 600; *People* v. *Peck*, 157 N. Y. 51; *In re Haight*, 32 App. Div. 496; *State* v. *Carson Savings Bank*, 17 Nev. 146; *State* v. *American*, 37 N. J. Law, 408; *Petition of Savings Bank*, 68 N. H. 384; *Berry* v. *Windham*, 59 N. H. 288; *Clement Nat. Bank* v. *Vermont*, 231 U. S. 120.

new 1921 method had been first suggested for the 1918 Revenue Act but failed of adoption.*

This new method of 1921 eliminated premiums from "gross income". It then defined "gross income" to include *only* such income as was "received during the taxable year" from "interest, dividends and rents" [§ 244(a)].

On the other hand, this new method eliminated from the allowable deductions many items that *other* corporations were permitted to deduct [Cf. §§ 234(a), 245(a)]. Instead of the former special deductions noted in the margin (page 8, *supra*), the 1921 Act allowed *only nine deductions* specifically itemized in nine separate numbered paragraphs of § 245(a), numbered from (1) to (9) inclusive, to-wit: (1) tax-exempt interest, (2) 4% of Reserve,† (3) dividends, (4) certain deferred dividends, (5) investment expenses, (6) real estate taxes and expenses, (7) depreciation, (8) interest paid out and (9) $2,000 specific exemption.

Item (6), real estate taxes and expenses, and Item (7) depreciation, are the only deductions involved in the present cases.

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* Cf. §§ 246(a)(1)(2), 247, of Senate Amendment 186 to Revenue Act of 1918 (Senate Report No. 617, 65th Cong. 3d Sess. H. R. 12863); §§ 244(a), 245(a)(1)(2) Revenue Act of 1921, 42 Stat. 261. Cf. Brandeis, *J.*, in *National Life* case, 277 U. S. at 523, note.

† The reason for allowing Item (2) as a deduction, *i. e.* 4% of Reserve, was that the "interest, dividends and rents" received, were used, in part, each year to maintain the legal Reserve. Consequently, when Congress allowed a deduction of 4% on the Reserve, it was not an arbitrary favor, as the Government repeatedly assumes in its Brief, but it was an *economic necessity*, so long as there was any pretense of "income" taxation; though, constitutionally, of course, Congress might have refused any deduction, and taxed the business into insolvency.*

* Some courts hold that the Reserve belongs to the company and may be taxed (*In re Oklahoma*, 173 Pac. 376, 13 A. L. R. 174; *Com. Life* v. *Kentucky*, 145 Ky. 284, 36 L. R. A. (N. S.) 226); while other courts hold that the Reserve is a debt (*Alabama Gold Life Ins. Co.* v. *Lott*, 54 Ala. 499; *Insurance Co.* v. *Board of Equalization*, 74 Iowa 178; *Insurance Co.* v. *Detroit*, 133 Mich. 408).

SUMMARY OF POINTS DISCUSSED.

1. Taxation of the "rental value" of the two Home Office Buildings, to the extent that they were occupied by their owners, was a "direct" tax on the land itself, levied solely because of ownership; and such a tax is void unless apportioned (pp. 12-38, infra).

2. The taxation of the "rental value" of property when occupied by the owner, was not a mere "correlation of deductions with the limited class of income to be taxed" (as the Government contends) but it was the levy of a "direct" tax upon real estate because the owner occupied it (pp. 39-47, infra).

3. The Government's theory,

(*a*) *That the Revenue Act allowed deductions* (*6*) and (7), *solely upon condition that the insurance company would consent to a tax upon the "rental value" of the real estate which it occupied; and, consequently,*

(*b*) *That having taken deductions* (*6*) *and* (*7*), *the insurance company is estopped from contesting the constitutionality of the "direct" tax upon the "rental value".*

is untenable, because Congress cannot impose an "unconstitutional condition" to wit, that a person shall surrender or waive a constitutional right as the price of receiving some benefit allowed to others (pp. 47-56, infra).

4. The Rockford Life was entitled to a deduction of $1,783.02 for depreciation on all its furniture and fixtures.

It should not be limited to an allowance of only $292.56 upon the small quantity of furniture and fixtures used exclusively in what the Commissioner calls the "Investment" Department of its business (pp. 57-69, infra).

FIRST POINT.

Taxation of the "rental value" of the two Home Office Buildings, to the extent that they were occupied by their owners, was a "direct" tax on the land itself, levied solely because of ownership; and such a tax is void unless apportioned.

1. The Independent Life actually "received during the taxable year" only $73,620 in 1923 and $71,289 in 1924 as rents from all the tenants in its building; it returned those sums as income and was duly taxed thereon (No. 689; R. 5-8):

The Rockford Life did not receive any* rent income whatever from its building.

All rents that the two insurance Companies derived from their real estate were "income" and subject to "income" taxation; were included in their returns; and were duly taxed—as to which they make no complaint whatever.

2. Nevertheless, the Commissioner determined a deficiency-tax against both Companies, by calculating a further 12½% income tax upon the "rental value" of the space occupied by them in their respective office buildings, which were *wholly owned* by them (No. 689; R. 5-8, 16; No. 722; R. 5-8, 13).

To the extent that the Commissioner seeks to impose such *further* "income" tax upon a supposed "rental value" of the space which the owner occupied in his own real estate, *solely by virtue of his ownership thereof*, we insist that the Commissioner is in error—because such a tax is not a tax on "income" (for there was *no* such income);

* Except $15 which was included in its income tax return and properly taxed (No. 722; R. 13).

but it is a "direct" tax on the land itself *imposed solely because of ownership*, which can only be levied by the rule of apportionment.

3. The Revenue Acts now in controversy seek, for the first time in constitutional history, to tax (without apportionment), not the rents actually "received during the taxable year," but an arbitrarily *assumed* "rental value" of land when *occupied by the owner;* and only then when the "owner" *happens* to be a life insurance company.

From the foundation of this Government it has been universally recognized by Congress, and held by this Court, that a tax levied upon dwelling houses, buildings, land or other real estate *because of the ownership thereof* was a "direct" tax that must be apportioned.*

We submit:

I. *The tax on the "rental value" of the Independent Life's 1-floor and of the Rockford Life's entire building, solely because occupied by them as the respective owners thereof, is a "direct" tax on the land itself, imposed solely because of its ownership; and the tax thereon is void for want of apportionment.*

If a Federal tax can be levied (without apportionment) upon the "rental value" of real estate—which is not in

* *Hylton* v. *U. S.*, 3 Dall. 171, 175, 176, 183; *Veazie Bank* v. *Fenno*, 8 Wall. 533, 544; *Scholey* v. *Rew*, 23 Wall. 331, 346-7; *Springer* v. *U. S.*, 102 U. S. 586, 596, 598, 602; *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, 581, 583, 621; *Id.* 158 U. S. 601, 627; *Knowlton* v. *Moore*, 178 U. S. 41, 81; *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 150; *Brushaber* v. *Union Pacific*, 240 U. S. 1, 15, 19; *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103, 114; *Eisner* v. *Macomber*, 252 U. S. 189, 205-6, 217; *Bromley* v. *McCaughn*, 280 U. S. 124, 136, 139.

Compare the "direct" apportioned taxes under Act July 14, 1798, 1 Stat. 597; *Id.* 580; Acts August 2, 1813 and July 22, 1813, 3 Stat. 164, 166; Act August 5, 1861, 12 Stat. 292, 294, as reviewed in the *Pollock case*, 157 U. S. at pp. 572-3; *Veazie Bank* v. *Fenno*, 8 Wall. 533, 542; and *Springer* v. *U. S.*, 102 U. S. 586, 598.

fact rented and from which no rentals are derived—so that a corporation may be subjected to a so-called "income" taxation upon the "rental value" of its own land when occupied by itself, then the following constitutional consequences to individuals necessarily ensue:

(1) The grocer, small shopkeeper, or physician who owns his own home and lives in its second story or in the back room of a cottage,—while his grocery, shop or doctor's office occupies the ground floor or front room of the cottage,—may also be subjected to "income" taxation on the "rental value" of the space so occupied by him in his business.

(2) Every owner of unimproved real estate or of vacant buildings, can be similarly taxed, *i. e.*, the owner of a *vacant* city lot, residence or office building or of unrented farm land, can be required to pay an "income" tax on some statutory measure of its "rental value"—although the property is actually vacant, uncultivated, and no revenue or income has been derived therefrom.

(3) The farmer who leaves a field idle (either to "rest" the ground or to reduce production under some recovery program); every dairyman who lets his cows go dry (to avoid a surplus of milk and to raise the price); and every landlord with empty tenements on his hands, can, each and all, be made to pay an "income" tax (including, perhaps, heavy surtaxes) on the imaginary "rental value" of his land or cows, which he has not in fact rented or hired out, and from which he has derived no income whatsoever.

But that is not all.

(4) Every individual owner of his own home can be required to pay an "income" tax on a similar imaginary

"rental value" of the space therein which he occupies with his family as his residence.

Those are illuminating illustrations of the reasons why this Court has so repeatedly emphasized that any tax levied in respect of real estate, *because of its ownership,* is a direct tax which must be apportioned (See note below).

[I.] A tax upon the "rental value" of land when occupied by the owner, is plainly a "direct" tax on the land itself, *imposed solely because of its ownership* [See authorities collated in the margin].

If an insurance company *rents* a building to use as its Home Office, but does not occupy all the space, the Revenue Act *does not tax* the company on the "rental value" of (*a*) the space it occupies or, (*b*) the vacant space which it does *not* occupy; and this is so solely because the company *does not own* the building.†

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* In *Knowlton* v. *Moore,* 178 U. S. 41, 81, referring to certain language in the *Pollock* opinion, Mr. Justice WHITE said that such language

> "was but a statement that a tax which was in itself direct, *because imposed upon property solely by reason of its ownership,* could not be changed by affixing to it the qualification of excise or duty."

Flint v. *Stone Tracy Co.,* 220 U. S. 107, quoted with approval that language from *Knowlton* v. *Moore,* and added (p. 150):

> "The act now under consideration does not impose direct taxation upon property *solely because of its ownership* * * * The *Pollock* case construed the tax there levied as direct, because it was imposed upon property *simply because of its ownership.*"

In *Brushaber* v. *Union Pacific,* 240 U. S. 1, 15, Chief Justice WHITE said that the Civil War income taxes were classed as excises, because

> "they were not taxes directly on property *because of its ownership.*" [Footnote continued on next page.]

† If an insurance company *owns* a building but *does not occupy any* space in it, then the Revenue Act taxes it *only* upon the rents actually collected from other tenants; and does not attempt to tax it for any alleged "rental value" of vacant space.

But, on the other hand, if an insurance company *owns* its Home Office building, and occupies any portion thereof (whether one room or several floors) the Revenue Act taxes it on the "rental value" of *all* the space it so occupies, and this tax is imposed *solely* because the company *owns* the building.

The Government may argue that the tax is not levied *solely* because of ownership, but because of (1) ownership, plus (2), *occupancy* of the thing owned. That is simply an argument that the owner of land or of personal property may be taxed (without apportionment) *for*

He also said, page 19:

> "* * * It is to be observed that, although from the date of the *Hylton Case* because of statements made in the opinions in that case it had come to be accepted that direct taxes in the constitutional sense were confined to taxes levied directly on real estate *because of its ownership*, the Amendment contains nothing repudiating or challenging the ruling in the *Pollock Case* that the word direct had a broader significance since it embraced also taxes levied directly on personal property *because of its ownership* * * *."

Eisner v. *Macomber*, 252 U. S. 189, 205, said that the *Pollock* case held taxes upon rents of real estate

> "were in effect direct taxes upon the property from which such income arose, *imposed by reason of ownership.*"

The Court said that of course Congress had power to tax shareholders upon their property interests, but added (p. 217):

> "But this would be taxation of property *because of ownership*, and hence would require apportionment under the provisions of the Constitution, is settled beyond peradventure by previous decisions of this Court."

In *Bromley* v. *McCaughn*, 280 U. S. 124, 136, it was said,

> "While taxes levied upon or collected from persons *because of their general ownership of property* may be taken to be direct, *Pollock* v. *Farmers Loan & Trust Co.*, * * *"

In his dissenting opinion in *Bromley* v. *McCaughn*, SUTHERLAND, *J.*, said (p. 139):

> "to levy a tax by reason of *ownership of property* is to tax the property, *Dawson* v. *Kentucky Distilleries Co.*, 255 U. S. 288, 294."

the privilege of occupying or possessing that which he owns; and that such a tax is not a "direct" tax on the thing owned, but is an *"excise"* tax for the *privilege* of occupying or possessing the thing owned.

If that argument is sustained, then the constitutional guaranty against "direct" taxes without apportionment, has been absolutely frittered away.

The very essence of ownership is the right to the possession (*i. e.,* the occupancy) of the thing owned.

In *Dawson* v. *Kentucky Distilleries Co.,* 255 U. S. 288, a Kentucky statute imposed a so-called "license" tax of 50¢ a gallon on distillers or warehousemen with respect to all whiskey withdrawn from bond or shipped in bond to a point outside the State. This Court decided that it was a "property" tax because the thing really taxed was the owner's *right to possession* of his own property; and that "to tax the right is to tax the value," saying by Mr. Justice BRANDEIS (p. 294);

> "But as stated by the lower court, 'the thing really taxed is the act of the owner in taking his property out of storage into his own possession (absolute or qualified) for the purpose of making some one of the only uses of which it is capable, *i. e.,* consumption, sale or keeping for future consumption or sale. . . . The whole value of the whisky depends upon the owner's right to get it from the place where the law has compelled him to put it, and to tax the right is to tax the value. To levy a tax by reason of ownership of property is to tax the property. Compare *Thompson* v. *Kreutzer,* 112 Miss. 165; *Thompson* v. *McLeod,* 112 Miss. 383."

As there, so here. A tax on the "rental value" of land does not have a single incident of a license, privilege, or occupation, unless it be the *privilege of ownership.* But to tax the privilege of *ownership,* is, according to the

holding of this Court in many cases (pp. 15, 16, note; *supra*) the very essence of "direct" taxation on the property itself.

The Revenue Acts now in controversy seek to tax the supposed "rental value" of land, only when *occupied* by the owner. What is that but a "direct" tax on the land itself?

Suppose Congress levied a $10 tax on every *owner* of real estate (regardless of the extent or value of the real estate owned); would it not be a "direct" tax on land, imposed solely by reason of the *ownership* thereof. Again, if the tax were 10% of the value of the land, it would equally be a "direct" tax.

Suppose Congress imposed a $25 tax on every owner of a residence for the *privilege* of owning the land or of *residing* therein; would not that be a "direct" tax on the land, imposed solely because of its ownership?

Would the nature of the tax be changed, if, instead of relating to residential property, it were $25 on every *owner* of a business house for the privilege of owning the house *and occupying it?* Or again, would the nature of the tax be changed, if, instead of being $25 flat, it were 5% of the assessed value of the land? Or if it were 12½% of the "rental value" which the owner *might* have collected as rents had he chosen to rent it out, instead of occupying it for his own purposes?

Congress can tax any lands owned, but it can only do so subject to the rule of apportionment. If the guaranty against a "direct" tax (without apportionment) can be avoided by a so-called *"excise"* tax for the privilege of *owning,* or for the privilege of possessing or *occupying* the land owned, the guaranty is nullified.

Suppose Congress levied a tax, which it termed an "excise" tax, upon each *landowner* for the privilege of possessing and occupying his land, the amount of such "excise" tax to be 5% of the value of the land owned. Such a tax would certainly be a "direct" tax on the land, or the English language has lost its meaning.

So here, a tax upon the "rental value" of the space which an insurance company occupies in the building which it owns, is just as "direct" a tax on the land as can well be imagined.

It cannot possibly be defended as an "excise" tax on the owner of the land for the *privilege* of owning or occupying the land which he owns. It is nothing more or less than a *"direct"* tax upon the land, *imposed because of its ownership.* The constitutional guaranty against taxation of land without apportionment, ceases to amount to anything, if, when the owner *occupies* that which he owns, he automatically loses the protection of the guaranty.

This Court has always held that a tax on land is a "direct" tax. If, then, this Court shall now decide that it is an "excise" tax, for Congress to tax a land-owner a percentage of (*a*) the market value of the real estate or (*b*) an annual "rental value", simply for the privilege of the land-owner occupying his own land, then the constitutional guaranty against direct taxation disappears, and nothing whatever is left of that fundamental guaranty. This is so, because, if it is constitutional to tax, without apportionment,—12½% of the assessed value of land, or alternatively 12½% of what the land might be rented for,—for the privilege of the owner occupying his farm, his cottage or his office building, then the door is open for Congress, without apportionment, to levy on land

any taxes that it pleases, absolutely without restraint or limitation, by the simple device of declaring that the tax so levied in respect of the land (whether a percentage of land value or a percentage of assumed annual rental value), is merely for the *privilege of owning, or occupying* the land so owned.*

If this Court shall now decide that it is *not* a tax on land, to make the owner pay in taxes a percentage of its possible rental value (when it is not in fact rented but merely *owned*), what becomes of the constitutional guaranty against the direct taxation of land without apportionment?

[II.] A tax on rents from real estate is still a "direct" tax on the land itself,—although the 16th Amendment has removed the necessity of apportionment in levying a tax on such rents.†

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* The historical matter submitted at the hearing of the *Pollock Case,* the two opinions of Chief Justice FULLER therein, and the repeated opinions of this Court before and after the *Pollock Case,* demonstrate that the framers of the Constitution well understood the distinction between "direct" and "indirect" taxation; that taxes on, or in respect of, the ownership of land were known to be *direct* taxes; that there was a great struggle over the grant of power to Congress to levy "direct" taxes; that the rule of apportionment was the compromise by which the adoption of the Constitution was secured; and that when the States surrendered certain great sources of revenue, they retained that of direct taxation, and limited its concurrent grant to Congress, so that Congress could not levy a tax on land except by apportionment.

† *Pollock case,* 157 U. S. at 583; 158 U. S. at 637; *Knowlton* v. *Moore,* 178 U. S. 41, 81; *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 148-50; *Brushaber* v. *Union Pacific,* 240 U. S. 1, 16-19; *Peck & Co.* v. *Lowe,* 247 U. S. 165, 172; *Eisner* v. *Macomber,* 252 U. S. 189, 205-6; *Bowers* v. *Kerbaugh-Empire Co.,* 271 U. S. 170, 174.

If a tax on rents *actually collected* is a "direct" tax on the land, *a fortiori,* a tax on the "rental value" of the land when occupied by the owner and *not* rented out, *and not collected,* is an even more *direct* tax on the land itself.

[Whether such *uncollected* "rental value" is "income" within the meaning of the 16th Amendment so that the tax thereon is relieved of apportionment, will now be considered, pp. 21-26, *infra.*]

II. *The "rental value" of land when occupied by its owner, does not constitute "income" to the owner within the meaning of the term "income" as used in the 16th Amendment.*

The Government may possibly contend that the "rental value" of space occupied by the owner of a building, is something which is of *benefit* to the owner, because unquestionably the owner derives a benefit from the space which he occupies, whether as a residence, shop, doctor's office or insurance quarters. Such a benefit is not "income" in the sense used in the 16th Amendment, but it is merely the benefit which *automatically flows from ownership.*

The Government's Brief apparently concedes that a tax on "rental value" is a "direct" tax on the land which must be apportioned (Government's Brief, pp. 8, 17); at least it does not make any argument to the contrary.*

* In response to the Government's suggestion (Brief, p. 17, *note*) that the Wisconsin *Income Tax Cases,* 148 Wis. 456, held that *"estimated rental value* of property occupied by the owner may be properly treated *as income* for State income tax purposes", we reply that the question here is not whether it is "income" in the *State* sense, but (1) whether a tax on "rental value" is a *"direct"* tax on land and (2) whether "rental value" is *"income"* in the sense of the 16th Amendment as defined by *this* Court.

In *Eisner* v. *Macomber*, 252 U. S. 189, 206, the Court said:

> "In order, therefore, that the clauses cited from Article I of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not 'income,' as the term is there used; and to apply the distinction, as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised.
>
> "The fundamental relation of 'capital' to 'income' has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop; the former depicted as a reservoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time. For the present purpose we require only a clear definition of the term 'income' as used in common speech, in order to determine its meaning in the Amendment; and, having formed also a correct judgment as to the nature of a stock dividend, we shall find it easy to decide the matter at issue.
>
> "After examining dictionaries in common use (Bouv. L. D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (*Stratton's Independence* v. *Howbert*, 231 U. S. 399, 415; *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 185)—'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the *Doyle Case* (pp. 183; 185).
>
> "Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The Government, although basing its argument upon the definition as quoted, placed

chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. *'Derived—from—capital';—'the gain—derived—from—capital,'* etc. Here we have the essential matter; *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in,* being *'derived,'* that is *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description."

In *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170, 174, this Court said:

"'Income' has been taken to mean the same thing as used in the Corporation Excise Tax Act of 1909, in the Sixteenth Amendment and in the various revenue acts subsequently passed. *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, 335; *Merchants L. & T. Co.* v. *Smietanka,* 255 U. S. 509, 519. After full consideration, this Court declared that income may be defined as gain derived from capital, from labor, or from both combined, including profit gained through sale or conversion of capital. *Stratton's Independence* v. *Howbert,* 231 U. S. 399, 415; *Doyle* v. *Mitchell Brothers Co.,* 247 U. S. 179, 185; *Eisner* v. *Macomber,* 252 U. S. 189, 207. And that definition has been adhered to and applied repeatedly. See e. g. *Merchants L. & T. Co.* v. *Smietanka, supra,* 518; *Goodrich* v. *Edwards,* 255 U. S. 527, 535; *United States* v. *Phellis,* 257 U. S. 156, 169; *Miles* v. *Safe Deposit Co.,* 259 U. S. 247, 252-253; *United States* v. *Supplee-Biddle Co.,* 265 U. S. 189, 194; *Irwin* v. *Gavit,* 268 U. S. 161, 167; *Edwards* v. *Cuba Railroad,* 268 U. S. 628, 633."

The benefit of occupying or using one's own property is much further removed from "income" than the stock dividends held in *Eisner* v. *Macomber* not to constitute "income" within the meaning of the 16th Amendment

Since a *growth*, or *increment of value*, to property is not "income" to the owner, surely mere occupancy of the property by the owner himself cannot be considered "income."

The B. T. A.'s full consideration of the subject and review of the authorities should be carefully read, from which we quote briefly as follows (No. 689; R. 27-29):

> "Thus the only theory upon which a tax on the *rental value* of real estate occupied by the owner could be laid without apportionment, would be that such rental value is income within the legal signification of that term as used in the Sixteenth Amendment.
>
> That it may be sometime regarded as income by economists some of whom may use the term as applying to benefits or enjoyments is not controlling, *Lynch* v. *Turrish*, 247 U. S. 221; *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509. Nor may we look to the use and meaning of the word income found in statutes of several of the States, for the same constitutional requirements do not exist to give force to the limitations of definition.
>
> Here the restriction upon Congress is that it may not use or define the term so as to bring about an unapportioned direct tax, and no authority can be attached to usage free from a similar restriction. The English usage to exclude profits from capital sales were disregarded in *Merchants Loan & Trust Co.* v. *Smietanka, supra;* and the Massachusetts usage to include stock dividends was disregarded in *Eisner* v. *Macomber, supra.* In the 1894 act, which was the precursor of the Sixteenth Amendment, rents were included, but no reference was made to *rental value*, and, as we have seen, the *Pollock* case took as a postulate that the use and value of realty was the realty itself rather than the income therefrom. The Corporation Excise Tax Act of 1909 used income in the same sense as a measure of excise tax, *Flint* v. *Stone, Tracy Co.*, 220 U. S. 107.
>
> Therefore there is nothing in the history immediately preceding the Sixteenth Amendment to give support to a

more expansive use of the word income than that considered in the *Pollock* case. **And clearly nothing can be said for treating rents—which indubitably are income—as including rental value of space owned and occupied.** Rent has since feudal times implied two separate persons and estates, those of landlord and tenant, and it would be a misnomer to apply it to the value of a landlord's use and occupancy of his own property. Thompson on Real Property; Tiffany on Real Property; 36 *Corpus Juris* 285, See also *Duffy* v. *Central R. R.* 268 U. S. 55.

It seems to us furthermore that a construction of income to include rental value of occupancy of realty by its owner would be to narrow the force of the requirement of apportionment to a point of practical nullification. * * *

Since, as we have seen, to tax the use or value of realty as distinguished from rents or profits is to tax the realty itself, it would result that although the requirement of apportionment would nominally remain applicable to a tax imposed *eo nomine* upon the realty itself, still a tax in the same measure upon rental value of realty occupied by the owner would escape apportionment. The speciousness of such a differentiation is obvious. * * *

[Here follows a review of nine authorities.]

While these several decisions deal with problems specifically different from the one at bar, they indicate a tacit recognition that income is more than mere use or enjoyment of one's own property in its original form. There must be some sort of consummated pecuniary gain from which the tax can be paid. We find no intimation that rental value of property occupied may be regarded as income any more now than at the time of the decision in the *Pollock* case."

The C. C. A. (6th) held that "rental value" was not "income" within the meaning of the 16th Amendment, saying (No. 689; R. 50-51; *Com'r.* v. *Independent Life*, 67 F. (2d) 470, 472):

"It might be said, with a fair show of reason, that benefit in the form of actual rental value accruing to one who

> occupies his own building is in the nature of income from rents. **But we may not adopt such conception here. We are required to follow the standard definition of income found in the Sixteenth Amendment and the interpretation thereof by the Supreme Court."**

Even TUTTLE, *J.* (C. C. A. 6th), who dissented, held that "rental value" does not constitute income, saying (R. 54-55):

> "I do not dissent on the ground that such 'rental value', however defined or computed, is taxable as income, or constitutes income * * *. Of course, even if it did actually represent rental value that would not meet the constitutional objection urged against its inclusion in, and as, income taxable under the Sixteenth Amendment, **for the obvious reason that rental value does not constitute income."**

We submit that the foregoing argument (pp. 13-26, *supra*) has established that, insofar as the Revenue Acts of 1921, 1924 and 1928 imposed a tax upon the "rental value" of the space occupied by the Independent Life and the Rockford Life in their own *wholly owned* Home Office buildings, it is a "direct" tax upon their lands and is void because levied without apportionment.

III. *The particular "rental value" which the Revenue Acts compelled the insurance companies to include as income (and to pay income taxes thereon) was an arbitrary sum having no reasonable relation to income in any constitutional sense.*

1. Regardless of whether the *fair* "rental value" of land which the owner left vacant or occupied himself, is held to be "income" to such owner, so that under the 16th Amendment it can be taxed without apportionment, still

the *particular "rental value"* prescribed by the Revenue Acts is not "income" in any possible sense.

The Revenue Act of 1932 recognized that such "rental value" was not "income" and completely altered the statutory provisions now in controversy (Cf. § 203(b) Revenue Act of 1932; Report of Senate Finance Committee No. 665, 72d Congress, 1st Session, p. 36; See full quotation in Government's Brief No. 689, at pp. 14-15, footnote).

2. The Revenue Acts, in controversy here, provide that if an insurance company occupies *any* part of its own property, it must return as income the "rental value" of the space so occupied, **which rental value so demanded, must be large enough** [after deducting taxes, expenses and depreciation, from actual rentals derived from other tenants] **to make a clear net income of 4% upon the "book value" of the entire building.**

In other words, after deducting taxes, expenses and depreciation from the actual rentals collected from all other tenants in the building, the company must also include in its income (as the rental value of the space it occupies) such further sum, as when added to the *net* rent received from the other tenants, will produce a *net* taxable rental income for the entire building of 4% upon its **"book value."**

Different companies carry their Home Office buildings on their "books" at various values and for various reasons—some high, some low, some even nominal or without any reasonable relation to *actual* value. The result is that one insurance company's "book value" of its building may bear no relation whatsoever to cost, rental

return or market value or to that of any other company's building.

All consistency in the taxation of Home Office buildings may be vitiated by the "book value" at which the particular company carries on its books. To illustrate: if the Metropolitan Life (pursuant to a conservative policy of showing only liquid assets to respond to policy demands) had charged down its $10,000,000 Home Office to a "book value" of $1.00, it could have occupied the entire building, deducted all taxes, expenses and depreciation thereon, and yet, under § 245(b), it would have been required to report as the "rental value" of its *entire* building, 4% of the "book value", which would be *only four cents.* This shows the utter arbitrariness of basing the "rental value" of space occupied, upon "book value."

To illustrate concretely; two companies, A and B, own ten-story office buildings, each having a book value of $500,000. A occupies *one floor* in its building; rents out three floors to other tenants; and has vacant six floors for which if can not find tenants. B does not occupy any space in its building; but rents it all to tenants. The taxes, expenses and depreciation are the same in each building.

	A		B
Rents from tenants.....	$20,000		$70,000
Taxes, Expenses, etc.....	60,000		60,000
	[*Deficit*] $40,000	[*Income*]	$10,000
Compulsory "Rental value" of space occupied by owner...	60,000		0
Rents forced to be reported as income	$80,000		$70,000

In other words, the Revenue Acts require A (with an *actual* deficit of $40,000) to report as the "rental value" of the *one floor* it occupies in its own building, the sum of $60,000, (and to pay income taxes thereon) which is (1) *three times as much* as A collects from all the tenants it can get from its *other nine floors* and (2) nearly as much as B collects from all the tenants in its *ten* floors.

The Revenue Acts require that every insurance company which occupies *any part* of its own building must pay a 12½% tax upon an alleged net income amounting to 4% of the book value of its entire building. No matter how much or how little space the company occupies; no matter how much or how little is occupied by other tenants; no matter how much or how little rental such other tenants may pay; and no matter how much or how little the taxes, expenses and depreciation are; the company must nevertheless, return, as the "rental value" of any space it occupies, **a sum large enough to create a minimum net rental for the entire building of 4% on its "book value".**

If the rentals from other tenants were quite large, and the taxes, expenses and depreciation were small enough, the company would not have to return any sum as the "rental value" for the space it occupied (*Atlas Life Ins. Co.*, 29 B. T. A., decided January 16, 1934, page 8).

On the other hand, if the amount received from other tenants were small or a large part of the building was vacant, the company, although occupying only one room or one floor, would have to return as the "rental value" thereof, a sum large enough to produce a net income from the building as a whole equal to 4% of its book value.

These considerations merely illustrate that the Revenue Acts, in thus defining what "income" the company shall return, do not use *any* definition of "income" which falls within the definitions prescribed by this Court in many cases, but prescribe as "income" a purely arbitrary and capricious sum, bearing no relation to reality or to any authoritative definition of "income".

To take the actual case of the Independent Life; it occupied but one floor in its twelve story building. The Commissioner held that it must return as "rental value" for that one floor $14,784 for 1923, (R. 18), and $34,400 for 1924, or nearly two and one-half times as much for the same space (R. 19). Why was this? It was because in 1923 the company realized from its tenants a net profit of $3,615, but in 1924 it had an actual operating *loss* of $14,269 (largely arising from an elevator accident)—so by the Revenue Acts' rule it had to report in 1924 as "rental value" for the same one floor space, enough *to wipe out* the entire loss, and also to bring out a hypothetical rental return for the entire building of 4% on its book value.

The B. T. A. aptly pointed out that the "rental value" which the company was required to return as "income" had no relation whatever to any constitutional definition of "income", saying (No. 689; R. 32):

> "By this [§ 245(b)], as has been seen, it is provided that no figure will be recognized as rental value of space occupied which is less than enough to bring about, with net rents received, a net income from the building of 4 percent of its book value. The mathematical operation of this provision in the case at bar has been already set forth.
>
> In 1923, it brought about a figure of $14,784.70 as the rental value of one story, to be added to $73,620.48 from tenants for eleven stories; for 1924, rental value of the

same one story was computed at $34,400.08, as compared with $71,289.21 received for the remainder.

Although the *rents* received were *diminished* from 1923 to 1924, and the *charges increased* from $70,005.18 to $85,918.87, giving an apparent indication of reduced rental value of space in the building, **the required formula forces an increased rental value of the story occupied to more than double.**

Whether this is typical of the application of the statute or unique does not appear. It is the actual situation as to this taxpayer brought about by the plain requirement of the statute, and to him it cannot be said that it is an extreme illustration.

As to 1924, it results in a tax based upon *artificial income* whereas in fact there has been a *loss*. Being unable to derive 4 per cent net income from the building, petitioner is nevertheless required to construct its tax return so that it will be taxed as if it did.

It seems clear that such a tax is not upon income, but its effect is to tax the realty itself, and what we have said as to the use of actual rental value in gross income **is more forcibly true as to such a forced minimum.** A 4 percent income from an insurance building may approximate an actual or average return (and we should perhaps assume that Congress so regarded it), but it is not true income within the Sixteenth Amendment unless it has in fact been derived from the property or capital invested. **To base the tax upon the assumption that it was in fact realized, irrespective of whether it was or not, is not the power granted by the Sixteenth Amendment; and since this is the only authority under which Congress assumed to act in title II, it must fail of its purpose and be held invalid.**

What we have said as to the use of the artificial 4 percent minimum is likewise true of the use of book value as its basis. How book value in any given case may be arrived at or what it means, is not set forth in the statute, and whether it has a meaning as to life insurance companies sanctioned by law does not appear. Regulations 62, issued under the Revenue Act of 1921, treat the

accounts of life insurance companies as uniform. But bookkeeping entries are not conclusive, *Doyle* v. *Mitchell Bros. Co., supra,* and the book value of property is not to be taken as actual value, *Virginia* v. *West Virginia,* 238 U. S. 202. Thus to take book value as the standard upon which the percentage return is to be measured is to depart from fact, and just so far to define income beyond its true bounds.

And we say this, even assuming that the particular book value represents actual cost with proper adjustments for wear and tear, etc., for if the investment has proved ill-advised the actual value may be far below cost and a 4 percent return on book value may be impossible to derive.

It is urged that the book value represents actual value where books are correctly kept. This is not necessarily true, as books may be said to be correctly kept, in a sense, when they truly state the items set forth. But cost carried forward may not be the same as present value. Despite repairs and renewals, a suitable allowance for depreciation may not have been made. It would be too much to say that there is any controlling presumption * * *.

On the other hand, in the absence of a more complete showing with respect to the physical property and its condition, the expenditures for maintenance and the extent of depreciation, it is wholly impossible to say that the book cost represented the actual value at the time to which the inquiry was addressed. Book cost, as we have said, would be a more or less doubtful criterion.' *Virginia* v. *West Virginia,* 238 U. S. 202.

Thus we are driven to the conclusion, despite the presumption to the contrary, that paragraph (b), although correctly construed and applied by respondent, invades this petitioner's constitutional rights."

The C. C. A. (6th) reached the same conclusion, saying (R. 51; *Com'r. v. Independent Life,* 67 F.(2d) 470, 473):

"Whatever might be said as to the power of Congress to require life insurance companies to include in their

gross income the actual or fair rental value of space occupied by them in their own buildings (a question not necessary here to determine) it is manifest to us that the amount required to be added to gross income under sec. 245(b), before deductions may be taken, is not income when measured by the rule in *Eisner* v. *Macomber, supra,* and *Bowers* v. *Kerbaugh-Empire Co., supra.* It does not represent actual gain. It is neither of exchangeable value nor is it severed from capital. It is not something received or drawn by the taxpayer for his separate use and disposal. It is simply an arbitrary figure, determined by a mathematical formula to which must be added rents received from other tenants and from which must be deducted taxes, depreciation and all other expenses to reach a net income of 4% per annum of the **book value** (not actual value) of the building at the end of any given taxable year.

It does not even purport to approximate the true rental value of the space occupied. It must be increased or diminished inversely, each year, to the increase or decrease of rents received. In *Burk-Waggoner Ass'n* v. *Hopkins,* 269 U. S. 110, 114, the court said: 'It is true that Congress cannot make a thing income which is not so in fact.' See, also, *Flint* v. *Stone Tracy Co.,* 220 U. S. 108, 145."

We submit that we have established that the tax imposed upon the arbitrarily determined "rental value" of the space respectively occupied by the Independent Life and the Rockford Life in their own buildings, was in reality a "direct" tax upon their real estate, without such arbitrary "rental value" bearing any reasonable relation whatsoever to income or even to benefit derived from their real estate.

IV. *The tax imposed by §§ 242-245 is an "income" tax; and it is not in any sense a "special excise" tax for the privilege of engaging in the life insurance business.*

In order to avoid the "direct tax" difficulty, the Government suggests that the tax imposed on life insurance companies by §§ 242-245, is not an "income" tax at all, but that it is a "special excise tax [which] need not be apportioned, but need only be geographically uniform" (Brief, pp. 6, 24, 25).

To that we respond:

(1) The Government unsuccessfully advanced the same argument* in *National Life Ins. Co.* v. *U. S.*, 277 U. S. 508, with respect to the same tax, imposed under exactly the same sections, involved here; and although Mr. Justice BRANDEIS (dissenting) spoke of it as "a special excise tax measured by net income", the majority of the court disagreed with his view as to the nature if the tax imposed (Cf. B. T. A.'s opinion R. 23).

The C. C. A. (6th) said that to hold the present tax to be a special excise tax (R. 52)

> "would be to deny the obvious fact. In form and substance the Internal Revenue Acts under consideration levy income taxes *and not excise taxes*".

Even the dissenting Judge, (TUTTLE, *J.*) said that Congress had imposed "an income tax"; that *"no effort* has been made in the act to impose an excise tax" (R. 53).

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* See Solicitor General's Brief, p. 19; Chas. E. Hughes' Brief, pp. 33-38.

(2) Mr. Justice BRANDEIS (dissenting) was, we think, in error when he said that,

> "Ever since Corporation Tax Act August 5, 1909 * * * the United States has laid upon life insurance companies a *special excise tax* measured by net income" (277 U. S. at 522).

Although the Corporation Tax Act of 1909 described the tax which it imposed as a *"special excise tax* with respect to carrying on or doing business" [which tax was sustained solely because it was in no sense an income tax but only an excise tax, *Flint* vs. *Stone Tracy Co.*, 220 U. S. 107, 147, 150, 151, 152, 167,] yet after the adoption of the 16th Amendment, the nine Revenue Acts of 1913, 1916, 1917, 1918, 1921, 1924, 1926, 1928 and 1932, described the taxes imposed therein by very different language. None of them described the tax as a "special excise tax" (as did the Corporation Tax Act of 1909), but every one of them described the tax as one on *"income"*. The pertinent provisions are collated in the margin.*

It is thus seen that all of these Acts, in practically the same language, impose specifically a tax directly upon a life insurance company's "entire net income", "total net income" or "net income". We do not recall that there

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* The Act of 1913 levied a tax "upon the *entire net income* arising or accruing from all sources . . . to . . . every insurance company." 38 Sta. 172.

The Acts of 1916 and 1917 levied "upon the *total net income* received in the preceding calendar year from all sources by every . . . insurance company . . . a tax of two per centum upon such income." 39 Stat. 765; 40 Stat. 333.

The Act of 1918 levied a tax "upon the *net income* of every corporation." 40 Stat. 1065-6.

The Acts of 1921, 1924, 1926, 1928 and 1932, levied a tax "upon the *net income* of every life insurance company." 42 Stat. 261; 43 Stat. 289; 44 Stat. 47; 45 Stat. 842; 47 Stat. 223.

has ever been a suggestion (other that from Mr. Justice BRANDEIS) that they were in the nature of a "special excise tax"; or that any of these Revenue Acts imposed an "excise" tax for the privilege of conducting the business of life insurance. The taxes were specifically designated as income taxes, *i. e.*, taxes upon *"income"*.

No doubt, had it chosen so to do, Congress might have imposed on life insurance companies, a "special excise" tax, measured by the net income; but it is not necessary to consider any question which might have arisen under some assumed hypothetical tax law which was never adopted.

Congress chose to tax life insurance companies (as it did individuals and other corporations), under the power to levy "income" taxes without apportionment; nor do we recall any suggestion that the taxes levied on the "income" of individuals and corporations by the series of Revenue Acts from 1913 to 1932 were not in fact "income" taxes, but were really *"special excise"* taxes. Until this Court decides that all of the specifically designated "income" taxes upon corporations, since 1913, are not "income" taxes at all, but are "special excise" taxes, it is needless to consider the subject further.

(3) *Massachusetts Mutual* vs. *U. S.*, 288 U. S. 269, was based upon the assumption that life insurance companies were subjected to an "income" tax rather than a "special excise" tax; because this Court assimilated life insurance companies to the same category as other taxpayers with respect to their "income" tax returns.

(4) The Revenue Acts of 1918, 1921, 1924 and 1926 [§238 (a)], and of 1928 and 1932 [§131 (a) (1)] pro-

vide for a credit to the taxpayer on his tax for the amount of any *"income"* tax paid to any foreign country. The Treasury Department has uniformly held that there can be no credit allowed for any *"excise"* tax paid to a foreign country; and that credit can only be had for taxes paid to a foreign country which are specifically designated as *"income"* taxes in such foreign country.*

This shows that the Government, administratively, will not permit an "excise" tax to be termed an "income" tax; and that the designation of a tax as an "income" tax is essential in order to be allowed as a credit when paid to a foreign country. If, then, in order to be an "income" tax within the meaning of our Revenue Acts so as to obtain a credit, it must be so designated in the foreign law imposing it, likewise when a tax is specifically designated as a tax on "income" in our Revenue Acts, it should not be held to be an "excise" tax in order to relieve it from the apportionment requirement.

(5) The Independent Life filed its return on Form 1120-L described by the Government, in large black type on the top thereof,

"Life Insurance Company Income Tax Return".

The return contains the words "gross income" once; "net income" *ten times,* and "income" twice.

Neither the word "excise" nor any other similar word is used. The same provisions as to abatements, refunds, overassessments, deficiencies, limitations and penalties apply to life insurance companies as apply to individuals and other corporations with respect to their *"income"* tax returns.

* If life insurance companies could get credit for "excise" taxes paid in a foreign country by calling them "income" taxes, the companies would obtain large further deductions.

Although there are many true "excise" taxes levied with respect to various kinds of business, it is not recalled that there is a single provision relative to such "excise" taxes which can be found anywhere in the law applicable to the "income" tax on life insurance companies here involved.

(6) *Flint* vs. *Stone Tracy Co.*, 220 U. S. 107, and *Stratton's Independence* vs. *Howbert*, 231 U. S. 399, arose under the 1909 Corporation Tax Act *before* any income tax had even been adopted. *Stanton* vs. *Baltic Mining Co.*, 240 U. S. 103, which arose under the 1913 Income Tax Act, was disposed of on the same grounds as *Brushaber* vs. *Union Pacific*, 240 U. S. 1; and its reference to *Stratton's Independence* was *dictum* and illustrative only.

The Government has cited no authority to lend any support to its suggestion that Congress, although specifically designating the taxation of life insurance companies as "income" taxation, nevertheless imposed, not an income tax, but a "special excise" tax.

SECOND POINT.

The taxation of the "rental value" of property, when occupied by its owner, was not a mere "correlation of deductions with the limited class of income to be taxed" (as the Government contends), but it was the levy of a "direct" tax upon real estate because the owner occupied it.

In order to avoid the "direct" tax difficulty, the Government urges that "Congress did not intend . . . to tax the rental value of space occupied by the owner"; that its only purpose was the *"correlation of deductions* with the limited class of income to be taxed"; and that the "inclusion in gross income of the rental value of the space owned and occupied by the taxpayers" was, in reality, a mere *"limitation upon the deductions"* (Government's Brief, pp. 8, 11, 17).

Without pretending to understand how a *tax* can be *upheld* by saying "Congress *did not intend*" to impose it, or how a *forced increase* in gross *income* can be called a *limitation upon deductions,* the Government's argument is based upon the following assumptions, each of which will be shown to be erroneous:

Government's erroneous assumptions.

(1) That a life insurance company's income consists of two *separate kinds* of income; one of which the Government terms *"Investment* income," and the other *"Underwriting* income."

(2) That Congress *taxed* the "Investment" income; but did *not* tax the "Underwriting" income: and Congress, thereby, conferred a great favor upon life insurance companies, by leaving a large part of their "income" *untaxed.*

(3) That, in authorizing the nine specific deductions (§ 245 (a) (1-9),), Congress *intended* to allow only deductions *connected* with the "Investment" income, which was to be *taxed.*

(4) That, in applying § 245 (a) (b), the Commissioner *must* administratively *carry out* the foregoing *assumed "intention"* of Congress, *regardless* of the language actually used in § 245 (a).

(5) That, when the company occupies *any part* of its building, then *all of the deductions* (6), (7) [Real estate taxes, expenses and depreciation] are *conclusively presumed* to be connected solely with the *"Underwriting"* income, which the Government assumes was *not* to be taxed; and hence to allow deductions (6), (7), would result in an unjustified "distortion" of the *"Investment"* income, which the Government erroneously assumes *was the only income to be taxed.*

Government's erroneous conclusions.

From the foregoing *erroneous assumptions,* the Government next deduces the following equally erroneous conclusions:

First; That Congress only intended to permit deductions (6) (7) [taxes, real estate expenses and depreciation] which were *directly connected* with earning so-called "Investment" income which was to be taxed, to wit, rents derived from tenants to whom portions of the building were rented; and that if a company, owning its own building, occupied *any part* of it, the benefit accruing from such ownership was in the nature of *"Underwriting"* income, which was *not* to be taxed;

Second; That, *consequently,* Congress never intended for the company to deduct (6) (7) [taxes, expenses and depreciation], if *any part* of the building were occupied by the company; but that, on account of the practical

difficulty of allocating such items between other tenants and the company itself, Congress attempted (to use the Government's phrase) "to correlate the deductions with the limited class of income to be taxed" (whatever that may mean), by providing that, whenever the company occupied any portion of its own building, if it deducted (6) (7) [taxes, expenses and depreciation] it *must include* as a part of its gross income, enough as "rental value" of the space it occupied, to bring out a net 4% return on the "book value" of the building.

We will now show the error in each of the Government's five erroneous assumptions.

(1) A life insurance company's income is not divided into two separate water-tight compartments known as "Investment" income and "Underwriting" income.

Wherever Congress has used the terms, "Investment income" and "Underwriting income", **it has expressly stated that those terms should not be applicable to life insurance companies*** (See pp. 66, 67, *infra*).

Prior to 1921, Congress did treat premiums received from policyholders as "income" to a life insurance company; but in order not to destroy the life insurance business, Congress allowed certain extraordinary deductions (not allowed to other corporations). But, as Solicitor General MITCHELL conceded in the *National Life* case, such a method of taxing *life* insurance companies "was unfair, unjust, and unsound in principle," because premiums paid by *life* policyholders *"are no more income to the company than are deposits in a bank income to the*

* See § 246 (a),(b) (3) (4) of the Revenue Acts of 1921, 1924, 1926, 42 Stat. 263, 43 Stat. 291, 44 Stat. 49; § 204 (a),(b) (3) (4) of the Revenue Acts of 1928 and 1932, 45 Stat. 844, 47 Stat. 226.

bank" (Brief, p. 12; our italics). Those italicized words of Solicitor General MITCHELL ought to be sufficient to demonstrate that there is no such thing as an *"Underwriting"* income to a *life* insurance company in any proper sense.

By the Revenue Act of 1921 Congress recognized its error in treating *life* insurance premiums as "income", even if it had tried to correct the error by allowing extraordinary deductions.

(2) By the Revenue Act of 1921 [the identic language of which has been carried forward into each of the subsequent Revenue Acts of 1924, 1926, 1928 and 1932] Congress completely changed its entire conception of what (from a taxation standpoint) constitutes a *life* insurance company's "income"; and Congress eliminated from "income" all premiums paid by policyholders.* Thereby, Congress authoritatively defined the "income" of a *life* insurance company to consist only of its "interest, dividends and rents." The B. T. A. made the keen forceful comment (R. 24):

> "By defining statutory gross income to include only interest, dividends and rents, the *intention was disclosed to omit all other factors from consideration. National Life Insurance Co.* v. *United States, supra. The effect* otherwise would be *to include* premium receipts in gross income to the uncertain extent necessary to make up in each case for items improperly included, such as interest from State securities, or capital property like stock dividends, and thus *to defeat* the manifest legislative *purpose to leave premium receipts entirely out of the income taxed.* Thus to Congress would be ascribed the recondite purpose of *ostensibly releasing* premiums from tax while *actually requiring them to be used to validate particular taxes which would otherwise invade constitutional rights.*

We reject this and treat the statute as candidly expressing its design and purpose."

From 1921 to the present time, a *life* company's "income" has consisted of nothing but its "interest, dividends and rents"; and if such items are to be called *"Investment"* income it only means that (from the standpoint of income taxation) such items constitute the *sole* "income" of a *life* insurance company.*

The Government repeatedly refers to premiums paid by policyholders as the company's *un*taxed "Underwriting" income. While such so-called "Underwriting" income *is not taxed*, this is not because it is *omitted* from taxation, but, because (from a taxation standpoint), Congress properly decided that it was *not* "income" in any proper sense.

Congress defined, and then taxed, that which constituted "income" to a life insurance company. It is not material whether such "income" be called merely "income," or *"Investment"* income, or any other catch-word to designate it. No so-called "Underwriting" income was left *un*taxed.

When, in 1921, Congress corrected its former error and changed its conception of what constitutes "income" to a *life* company, it did not leave *un*taxed any amount of "income", or thereby confer some special favor upon *life* companies, which might seem to authorize the Com-

* As Solicitor General MITCHELL perceived, Congress ought never to have included "premiums" as any part of a life insurance company's "income," just as Congress never included "deposits" in the "income" of a bank. Congress always followed the correct idea in taxing "income" of banks; but from 1913 to 1921, Congress did not follow the correct idea as to life insurance companies, even though it tried to counter-balance its error by allowing certain extraordinary deductions to the *life* companies.

missioner to seek some unexpressed congressional intention, in order to counter-balance the supposed favor, by imposing some extra burden upon the companies.

Congress determined upon the method of taxing the "income" of *life* companies, and upon the deductions to be allowed. There was no question of *favor* to the companies, or of *omission to tax* any part of their "income". An authoritative and comprehensive plan was adopted, which should be carried out as laid down by Congress, rather than according to the Commissioner's view of some supposed, but unexpressed, "intention" of Congress.*

(3) As Congress did not subdivide a life insurance company's "income" into (*a*) an "Investment" income *to be taxed*, and (*b*) an "Underwriting" income to be left *un*taxed, it necessarily follows that the deductions authorized by § 245(a)(1-9) were intended by Congress to be deducted from the Company's total "income" as defined by Congress.

Congress never intended that such deductions should be *allowed only* in connection with what the Commissioner elects to style *"Investment"* income; and, in some undefined way, *kept separate* from what the Commissioner choses to designate as a so-called *"Underwriting"* income.

The basis of the Government's argument in the case at bar is that with reference to the deductions in controversy [*i. e.*, (6) (7), relating to taxes, expenses and depreciation on the building *occupied by the owner*], Congress had *two unexpressed* "intentions", to wit,

* As a matter of fact, for many years past, life insurance companies, on account of increased policy claims and deferred dividend business vanishing, would have paid considerably less tax under the old (1913-1920) method of taxation than under the 1921 Act's definition of "income".

First; That those deductions (6) and (7) should be allowed only in connection with "rents" collected from tenants; and

Second; That those same deductions (6) and (7) should be *disallowed* if the owner *occupied* any part of his own building, instead of renting the whole building to other tenants.*

The foundation of the Government's argument in the case at bar is destroyed, when it is once demonstrated (p. 41 *supra;* pp. 66, 67 *infra*), that a company's income is *not* segregated into "Investment" income and "Underwriting" income, upon which the Government can superimpose an *implied* "intention" of Congress that the specific deductions allowed should be further restricted to such further *"Investment"* income!

(4) In view of the plain, unambiguous language of § 245(a)(6)(7), and of the foregoing arguments, it is clear that Congress did not have any *unexpressed* "intention" that deductions (6) (7) should be allowed as to that part of the building producing what the Commissioner styles "Investment" income, and *disallowed* as to that part of the building *used* by the owner in the production of what the Commissioner styles "Underwriting" income.

(5) The deductions under § 245(a)(6)(7) of taxes, expenses and depreciation on the Independent Life building (of which only one floor was occupied by the company) were not, as the Government assumes, exclusively connected with the imaginary *"Underwriting"* income

* Unless, of course, the owner would submit to the void tax on the "rental value" of the space he occupied solely by reason of ownership.

claimed to be *un*taxed—which is the basis of the Government's argument in this case; but those deductions were directly connected with the Independent Life's *general* "income," *which was taxed.*

From eleven stories of the building which were occupied by tenants, with perhaps some vacant space, there were $70,000 rentals collected from tenants, and only one floor was used by the company (pp. 4, 5, *supra*). The Government claims that the allowance of deductions (6) (7) would result in a "distortion" of the imaginary *"Investment"* income, which was to be taxed. Obviously, the assumption which the Government has made in these respects is entirely erroneous, for the reasons heretofore pointed out, to wit, that the Independent Life's "income" was not segregated into *two separate water-tight compartments,* one consisting of so-called "Investment" income, subject to taxation, and the other, "Underwriting" income, *omitted* from taxation; but the Independent Life had one homogeneous "income" as defined by Congress; and there was, from the standpoint of income taxation, *no income left untaxed.*

In the case of the Rockford Life which occupied its *entire* building, the Commissioner disallowed *all* the $4,033.05 deductions for taxes, expenses and depreciation, because, according to the Commissioner's *theory,* they were connected with *un*taxed *"underwriting"* income, and the Rockford Life failed to consent to be taxed on the "rental value" of its own building.

Having shown the erroneous character of the five assumptions upon which the Government's argument rests, its conclusions are vitiated.

The unconstitutionality of a tax (without apportionment) upon the "rental value" of property, *only when occupied by the owner,* cannot be saved upon the theory that the tax is not a tax, but is a mere "correlation of deductions"! After a taxpayer has been *compelled to pay a tax* on "rental value" he can never believe that it is not a *tax,* but only a beneficent "correlation of *deductions.*"

The Commissioner's theory that the tax on "rental space" is *not* a tax, but is a "correlation of *deductions*", based on his separation of "Investment" and "Underwriting" income, *plus* his theory of Congressional "intention", becomes so confused that it is needless to follow it further.

THIRD POINT.

The Government's theory,

> ***(a) That the Revenue Act allowed deductions (6), (7), solely upon condition that the insurance company would consent to a tax upon the "rental value" of the real estate which it occupied; and (consequently),***
>
> ***(b) That having taken deductions (6), (7), the insurance company is estopped from contesting the constitutionality of the "direct" tax upon the "rental value,"***

is untenable; because Congress cannot impose an "unconstitutional condition", to wit, that a person shall surrender or waive a constitutional right as the price of receiving some benefit allowed to others.

The Government contends that the deductions allowed by § 245 (a) (6) (7) were granted "upon a condition", to wit, that the Company should, as the price of receiving such

deductions, include as a part of its income a large enough sum as the "rental value" of the space it occupied, to produce a *net taxable income* of 4% on the "book value" of the entire building; and that the company was *given the option* between (1) taking the deductions and submitting to the tax, or (2) not taking the deductions and not paying the tax, saying (Government Brief, pp. 28, 11, 30):

> "The allowance of deductions from taxable income . . . is a matter of legislative sufferance or permission. A reasonable condition attached to the allowance should not be open to question by one who has claimed the deduction allowed * * *.
>
> § 245(b) makes the taking of the deductions *conditional* upon the inclusion in gross income of the rental value of the space owned and occupied by the taxpayer . . . There is no compulsion involved, for the taxpayer *has an option* and is not required to report or account for the rental value of the space occupied by it unless it decides to claim the deductions. In each case the insurance company is free to weigh the practical advantage to it involved in *exercising the option* provided by statute."

To that argument, we reply:

I. The Government's theory limits the "condition" solely to *ownership* of land, when *occupied* by the owner by virtue of his ownership. This makes land, *when owned and occupied by the owner*, the sole basis of the classification by which the taxation of "rental value" is imposed. But that is precisely what the framers of the Constitution intended to prevent by their *twice repeated* prohibition against "direct" taxes (without apportionment). They intended to prevent any tax being levied on the basis of *land* ownership (Cf. pp. 13 note, 15-16 note, 20 note, *supra*).

II. The Government made exactly the same argument* in *National Life Ins. Co.* v. *U. S.*, 277 U. S. 508, where it was rejected as follows:

> "The suggestion that, as Congress may, or may not, grant deductions from gross income at pleasure, it can deny to one and give to another, is specious but unsound * * * Congress had no power purposely and directly to tax State obligations *by refusing to their owners deductions allowed to others.*"

As there, so here:

By § 245(a) (6) (7) Congress, first, allowed generally to *all* life insurance companies, deductions for taxes, real estate expenses and depreciation. But after doing so, Congress, second, by § 245(b), said that no *life* company *which owned and occupied any part of its own land* could take those deductions, *"unless"* such company consented to be taxed on the "rental value" of its own-occupied-land upon the arbitrary "book value" basis heretofore explained (pp. 26-33, *supra*). But as that "rental value" tax is a void "direct" tax (pp. 13-26, *supra*), Congress simply attempted, as in the *National Life* case, to attain a prohibited result "by refusing to their owners deductions allowed to others" (277 U. S. 522). It refuses to life companies which *occupy* their own land, the deductions which it allows to all other life companies who do *not* occupy their own land—thus making the owner's *occupancy* of his own land the basis of distinction, unless the latter will submit to a "direct" tax on his land.

* That the Government had unlimited power to grant or refuse deductions to a taxpayer; that it could grant a deduction upon "condition" that the taxpayer submit to such qualification or limitation as Congress prescribed; and, specifically, that Congress could *limit* the deduction allowed of 4% of Reserve, by the amount of the taxpayer's *tax-exempt income.*

In one respect, the case at bar is even stronger than the *National Life* case. There, the same § 245(a) (1) (2) allowed the deduction of tax-exempt income, but said that another deduction should be merely *reduced* by the amount of such tax-exempt income; and the prohibited result sought to be attained was the taxation of State bonds, which, after all, only came from an *implied* prohibition arising out of this Court's prior decisions against taxing State bonds. Here, the same § 245, *first* allowed the deductions (6) (7), but then says—not that they shall be merely *reduced*, but that they shall be *denied* in *toto*, unless the company submits to this void "direct" tax, which the Constitution itself *twice expressly prohibits*.

Where the Constitution expressly prohibits Congress from doing something, can Congress say to Taxpayer A, "We will grant you such a deduction,"; and then say to Taxpayer B, "We refuse to you the deductions we have just granted to A, unless you consent to pay the tax which the Constitution prohibits us from levying on you."?

III. The allowance of deductions from income is a matter of Congressional permission; but the power to grant or refuse deductions, does not give Congress the absolute power to make a *conditional* deduction. The moment that Congress undertakes to grant a deduction "*upon a condition*" (as the Government frankly admits (p. 28) it has done in this case), we are faced with the question of "unconstitutional conditions," so earnestly debated in this Court for half a century, resulting in the settled rule that even the possession of an unqualified power (absolute and unconditional in terms), does not carry with it the uncontrolled right to exercise such

power in a *conditional* manner; and if the power is exercised in a conditional manner, the condition must not be repugnant to, or require the surrender of, any right secured by the Constitution.*

A condition requiring a taxpayer to submit to a direct tax upon his land without apportionment, *is* repugnant to the Federal Constitution.

The power to impose conditions cannot be used to accomplish a prohibited result (*Miller* v. *Milwaukee*, 272 U. S. 713, 715; *Nichols* v. *Coolidge*, 274 U. S. 531, 541-2).

Congress cannot say to a citizen, "We grant you such and such a privilege 'upon condition' that you permit your property to be taken by Congress without due process of law,"; nor can Congress grant to one State the right to build bridges over navigable rivers "upon

* Although the *Doyle* and *Prewitt* cases held that a State might grant a foreign corporation the right to do business in the State upon condition that it should lose that right if it removed a case to the Federal Court, this Court *abandoned that doctrine*, upon the ground that a condition repugnant to the Federal Constitution, could not be imposed. Contrast majority and dissenting views in *Doyle* v. *Continental Ins. Co.*, 94 U. S. 535, 542, 543; *Security Mutual* v. *Prewitt*, 202 U. S. 246, 257-259, *et seq.*; *Western Union Tel. Co.* v. *Kansas*, 216 U. S. 1, 30-48, 54, 55; *Pullman Co.* v. *Kansas*, 216 U. S. 56, 62, 75; *Ludwig* v. *Western Union Tel. Co.*, 216 U. S. 146, 163.

Compare *Southern Ry. Co.* v. *Greene*, 216 U. S. 400, 416; *Herndon* v. *C. R. I. & P. Ry.*, 218 U. S. 135; *Harrison* v. *St. L. & San Francisco R. R.*, 232 U. S. 318, 328, 332, 333; *Phoenix Ins. Co.* v. *M. Masters*, 237 U. S. 63, 71; *Wisconsin* v. *Phila. & Reading Coal Co.*, 241 U. S. 329; *Terral* v. *Burke*, 257 U. S. 529; *Mortensen* v. *Security Ins. Co.*, 289 U. S. 702.

For a full history of the battle over "unconstitutional condition," see Appellee's Brief (p. 30-76), in the *Terral* case, 257 U. S. 529, and Appellee's Brief (p. 30-80) in the *Mortensen* case, 289 U. S. 702.

condition that such State shall consent that Congress may give a preference to the ports of some other State over its own ports.

Can Congress grant to all taxpayers generally certain deductions from their income and then annex the "condition" that any taxpayer who is the "*owner*" of a house must, in order to obtain the deductions granted, consent that soldiers in time of peace be quartered in such house?

In *Frost Trucking Co.* v. *R. R. Com.* 271 U. S. 583, 593, it is said:

> "It would be a palpable incongruity to strike down an act of state legislation which, by words of express divestment, seeks to strip the citizen of rights guaranteed by the federal Constitution, but to uphold an act by which the same result is accomplished *under the guise of a surrender of a right in exchange for a valuable privilege which the state threatens otherwise to withhold.* It is not necessary to challenge the proposition that, as a general rule, the state, having power to deny a privilege altogether, may grant it upon such conditions as it sees fit to impose. But the power of the state in that respect is not unlimited; and one of the limitations is that **it may not impose conditions which require the relinquishment of constitutional rights. If the state may compel the surrender of one constitutional right as a condition of its favor, it may in like manner, compel a surrender of all. It is inconceivable that guaranties embedded in the Constitution of the United States may thus be manipulated out of existence.** * * *
>
> May it stand in the conditional form in which it is here made? If so, constitutional guaranties, so carefully safeguarded against direct assult, are open to destruction by the indirect but no less effective process of requiring a surrender, which though, in form voluntary, in fact lacks none of the elements of complusion. Having regard to form alone, the act here is an offer to the private carrier of a privilege, which the state may grant or deny, upon a condition, which the carrier is free to accept or reject. In reality, the carrier is given no choice, except a choice between the rock and the whirlpool,—an option to forego a privilege which may be vital to his livelihood or submit to a requirement which may constitute an intolerable burden."

IV. If this Court shall decide that § 245 (b) is constitutionally permissible, then whenever a taxing authority, State or Federal, wishes to accomplish a prohibited result, it may do so by providing that unless the taxpayer agrees to submit to the thing prohibited, he shall not be allowed to receive Deductions otherwise allowable. The door will be wide open for the States, as well as for Congress, by simple statutory amendments, to nullify many of this court's most important rulings as to tax-exempt property.

A few illustrations will be illuminating:

In *Evans* v. *Gore*, 253 U. S. 245, the Revenue Act of 1918 gave to taxpayers generally the right to certain Deductions summarized in the margin.*

This Court held that § 213 was void as applied to Federal Judges' salaries, because it required the inclusion of such salaries in their return of income. Thereafter a Federal Judge, in returning his income, was entitled to omit his salary.

Suppose that in order to evade *Evans* v. *Gore*, Congress should apply the device of § 245(b) to the case of Federal Judges, by providing that none of the above Deductions allowed to taxpayers generally should be made by a Federal Judge, **unless he included his salary in his return of income.**

A Federal Judge would have the same free option which the Government insists in the case at bar is open to an insurance company, namely, he could either (1) avoid an unconstitutional tax, but, in such event, he could not receive the Deductions given to all other taxpayers; or

* The Deductions so allowed were for interest paid on debts, taxes, losses, bad debts, depreciation and charitable contributions. (Revenue Act of 1918, § 214; 40 Stat. 1066).

(2) he could accept the amended Act, receive the Deductions which tax payers generally receive, **and submit to the unlawful tax.**

Would this court approve such a device for evading the constitutional exemption of the Federal judiciary from a diminution of their compensation during their terms of office?

Suppose a Federal Judge claimed the Deductions allowed other tax payers, but did not return his salary as part of his income. Could it be said, as the Government argues here, that the Federal Judge, having taken the Deductions, would be estopped from disputing a tax upon his judicial salary? We submit that such an amended Act would be void because it made the granting of Deductions generally, subject to a condition that a Federal Judge should submit to an unconstitutional tax upon his salary.

In each of the leading cases cited in the margin*, a State taxing statute gave to the tax payer certain Deductions; and in each instance this Court held that the statute was void because the tax payer was entitled to an additional Deduction on account of some item of property which the State had no constitutional power to tax. Could New York, Kentucky, California, Pennsylvania, Wisconsin and Missouri evade this court's decisions by amending their respective Acts (in exact accordance with the device of § 245(b)), by providing that the tax payer should not have the regular Deductions allowed other tax

* *People* v. *Weaver*, 100 U. S. 539; *Louisville & Jeffersonville Ferry Co.* v. *Kentucky*, 188 U. S. 385, *Bank of California* v. *Richardson*, 248 U. S. 476, *Frick* v. *Pennsylvania*, 268 U. S. 473, *Miller* v. *Milwaukee*, 272 U. S. 713, *Northwestern Mutual Life Ins. Co.* v. *Wisconsin*, 275 U. S. 136, *National Life Ins. Co.* v. *U. S.*, 277 U. S. 508, *Missouri* v. *Gehner*, 281 U. S. 313.

payers, unless he would consent to be taxed upon the particular item which this Court had said could not be taxed?

To illustrate: *In Frick* v. *Pennsylvania*, 268 U. S. 473, the State Inheritance Tax Law permitted the deduction of "Debts and administration expenses" from the gross estate. This Court held that Pennsylvania could not tax certain tangible personalty in New York and Massachusetts, which must be deducted from the gross estate before it was taxed.

Suppose that Pennsylvania, in order to defeat the doctrine of the *Frick* case, had adopted an amended statute which provided that no estate should claim a deduction for "Debts and administration expenses", unless it consented to be taxed on the tangible property in other states.

Would such a law be valid?

V. The B. T. A. aptly said (R. 31):

> "It should not be overlooked that the condition of paragraph (b) is not applicable alone to such amount of the deductions under (6) and (7), *as compares with space occupied*, but operates as a condition of such deductions in any amount in respect of *the whole building*. Unless the taxpayer returns as gross income the rental value of the one story occupied, *it may not have any deductions whatever* of the charges applicable to any part of the building, notwithstanding all rents received are returnable. The alternative given is to pay tax on gross rents received without deduction or to pay tax on net rents received plus rental value of space occupied. This, we think, is subject to at least the objection stated by the Supreme Court in the *National Life Insurance Co.* case, and is consequently an invalid provision."

The C. C. A. (6th) said (R. 52):

> "Respondent has accepted no benefits under sec. 245 (b) of either act. None are in effect granted therein. It

has chosen, as it had a right to, to claim deductions allowed by sec. 245 (a)(6) and (7) of each act and to resist deficiency assessments founded upon the compulsory inclusion in gross income of that which cannot in any sense be regarded as income. The record fails to disclose that respondent has acquiesced in the provisions of these sections or recognized them as valid. See *Frost* v. *Corporation Commission*, 278 U. S. 515, 528. We therefore conclude that the inclusion of the indicated items in respondent's gross income for 1923 and 1924, respectively, as the rental value of the space occupied by it in its building, was in effect the taxation of something nontaxable (*Evans* v. *Gore*, 253 U. S. 245; *Miles* v. *Graham*, 263 U. S. 501) and was invalid.

"It is said that the purpose of sec. 245 of each act was, not to include in gross income that which was not income, but to *limit the deductions*. * * * It is urged that this may be done because deductions are statutory, and, although income is controlled by the Constitution, Congress may grant deductions or withhold them entirely or limit the amounts thereof. * * *

Congress may of course allow to all life insurance companies the deductions granted in sec. 245(a) (6) and (7), but having done so it cannot then say that it will deny these same deductions to those life insurance companies which own and occupy in whole or in part their own real estate unless they submit to taxation upon income which is nonexistent."

Judge Tuttle's dissent in the C. C. A. (6th) (R. 54-55) presents the same argument that was unsuccessfully made by the Government in the *National Life* case. The thing which Judge Tuttle urges is identically the thing that the *National Life* case decided *could not be done.*

We agree with his illustrations—both algebraically *and* constitutionally.

Indeed that was the precise argument which the *National Life* successfully made. The trouble with Judge Tuttle's argument is that if a tax on "rental value" is tax-exempt (without apportionment), then this Court held in the *National Life* case that the two equations given by Judge Tuttle were *identical* and both *equally unconstitutional.*

NO. 722: ROCKFORD LIFE CASE

"FURNITURE AND FIXTURE" CONTROVERSY

FOURTH POINT.

1. The Rockford Life was entitled to an allowance of $1,783.02 for depreciation on all its furniture and fixtures.

2. It should not be limited to an allowance of only $292.56 upon the small quantity of furniture and fixtures used exclusively in what the Commissioner calls the "Investment" department of its business.

Relevant Statute.

§ 203(a)(7) of the Revenue Act of 1928 (45 Stat. 791, 842-3) provided that a life insurance company was entitled to deduct from its "gross income",

> "(7) DEPRECIATION—A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence."

The Facts.

It was stipulated (No. 722; R. 14):

1. "A reasonable allowance for depreciation" of the Rockford Life's "furniture and fixtures for 1929 was $1783.02."

2. But the Commissioner allowed only $292.56, because the Commissioner held that the $1490.46 "balance of depreciation on furniture and fixtures applied to petitioner's [Rockford Life] insurance business and was therefore not deductible."

The Contentions of the Parties.

The Rockford Life contends that § 203(a) (7), *supra,* meant exactly what it said, viz. a deduction of "a reasonable allowance" for depreciation *"of property"*, which, by express stipulation, *supra,* was $1,783.02 for the furniture and fixtures (No. 722; R. 15; 27 B. T. A. 1419).

On the other hand, the Commissioner contends that § 203(a)(7) should be *construed* to limit the deductible depreciation to *such property only* [in this case "furniture and fixtures"], as the company *"used"* in what the Commissioner termed the *"Investment* Department" (No. 722; R. 7); and that it could not deduct any depreciation upon furniture and fixtures used in what he chooses to call "the *underwriting* department of the company" (No. 722; R. 23-24; 67 F. (2d) 213).

The Decision Below.

The B. T. A. decided that the Rockford Life was entitled to the agreed $1,783.02 allowance for depreciation on *all* of its furniture and fixtures, upon the authority of the B. T. A.'s settled rule on that subject as expressed in *Lafayette Life Ins. Co.,* 26 B. T. A. 946,951, followed in *Manhattan Life Ins. Co.,* 28 B. T. A. 129, *Missouri State Life Ins. Co.,* 29 B. T. A. , and *North American Reassurance Co.,* 29 B. T. A. [No. 722; R. 15; 27 B. T. A. 1419].

The C. C. A. (7th) reversed the B. T. A., upon the authority of its opinion in *Com'r* vs. *Lafayette Life,* 67 F. (2d) 209, 211 (No. 722; R. 23; *Com'r* vs. *Rockford Life,* 67 F. (2d) 213).

We submit that the B. T. A.'s decision was correct, and that the C. C. A. (7th) was in error, for the following reasons:

I. Legislative History.

(1) The Revenue Acts of 1916 and 1917 in identic language, and of 1918 in almost identic language, provided that all corporations, including *all insurance companies,* should be entitled to

> "a reasonable allowance for the exhaustion, wear and tear *of property* arising out of its use or employment in the business or trade."*

Therefore, from 1909 until 1921 Congress gave to *every* insurance company an allowance for depreciation "of property" *used or employed in its business.*

(2) By the Revenue Act of 1921, followed by identic language in the Revenue Acts of 1924, 1926, 1928 and 1932† the previous restriction to "use or employment in the business or trade" was *omitted* as to life insurance companies. It was provided that *life insurance* companies—distinct from all other corporations and distinct from *all* other kinds of *insurance* companies—were entitled to

> "DEPRECIATION—A reasonable allowance for the exhaustion, wear and tear *of property,* including a reasonable allowance for obsolescence."

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* The Revenue Act of 1916, § 12(a), 39 Stat. 756, 768; Revenue Act of 1917, § 12(a), 40 Stat. 300; Revenue Act of 1918, § 234(a)(7), 40 Stat. 1057, 1077-8 (Cf. Corporation Tax Act of August 5, 1909, § 38; 36 Stat. 11, 112; Act October 3, 1913, Section II G(b), 38 Stat. 114, 172).

† § 245(a)(7) of the Revenue Acts of 1921, 1924 and 1926, 42 Stat. 227, 261, 264; 43 Stat. 253, 289, 290; 44 Stat. 9, 47, 48; and § 203(a)(7) of the Revenue Acts of 1928 and 1932, 45 Stat. 791, 842-3; 47 Stat. 169, 224, 225.

By the 1921-1932 Revenue Acts just quoted, Congress did not place any limitation as to the character or the use *of property* on which a *life* insurance company was entitled to claim a depreciation allowance. But on the contrary, Congress gave to *life insurance* companies—as distinguished from corporations generally and from all *other* kinds of *insurance* companies—the broadest possible description of the property on which a depreciation allowance might be claimed by a *life insurance* company; *i. e.*, instead of limiting the depreciation allowance on property to that *"arising out of its use or employment in the business or trade,"* as was provided prior to 1921, Congress omitted those *italicized* qualifying words. While retaining part of the old phraseology, *i. e.*, "a reasonable allowance for the exhaustion, wear and tear *of property*" Congress deliberately *omitted* the former qualification as to "use or employment in the business or trade." That change in language shows that Congress intended that, after 1921, *life* insurance companies should have "depreciation" on *all their property*, whether or not it was used or employed in the business.

(3) As if to emphasize and reinforce that Congressional intention on this subject, the Revenue Acts of 1921, 1924, 1926, 1928 and 1932 continued to provide as to corporations generally, and as to all insurance companies *other* than *life* insurance companies, that the allowance for depreciation should continue to be limited to property "used in the trade or business".*

*§ 234(a)(7) of the Revenue Acts of 1921, 1924 and 1926, 42 Stat. 227, 255, 43 Stat. 253, 284, 44 Stat. 9, 42; § 23(K) of the Revenue Acts of 1928 and 1932, 45 Stat. 791, 800, 47 Stat. 169, 181.

It would be difficult to find a more striking and conclusive proof that Congress intended that *life* insurance companies should be entitled to a reasonable allowance for depreciation upon *all* of their "property," because, *First,* Congress *changed the old language* in order to express that intention; while, *Second,* at the same time, as to corporations generally and as to all insurance companies *other* than *life* insurance companies, Congress *retained* the old language of the Revenue Acts of 1916-1918 still limiting as to them, the depreciation of property to such as arose *"out of its use or employment* in the business or trade."

II. Administrative History.

For nearly ten years after the passage of the 1921 Revenue Act, the Commissioner (overlooking or disregarding the fact that there was an even broader provision for depreciation as to *life* insurance companies than was applicable to corporations generally and to *other* kinds of insurance companies) held that the depreciation deductions allowed to *life* insurance companies were *"identical"* with those allowed to other corporations.*

Accordingly, during that period of nearly ten years, the Commissioner allowed to all *life* insurance companies a reasonable allowance for the depreciation of *all* of their "furniture and fixtures" without distinction as to the *particular use* they were put to in the company's business.

About 1930 or 1931 the Commissioner (abandoning his practice of ten years) conceived the new idea that,

* Cf. Art. 685(2) of Regulations 62 under Revenue Act of 1921, Regulations 65 under Revenue Act of 1924; and Regulations 69 under Revenue Act of 1926; Art. 975(2) of Regulations 74 under Revenue Act of 1928; Art. 975(2) of Regulations 77 under Revenue Act of 1932. See quotation from B. T. A. opinion, page 64, *infra.*

as to the "furniture and fixtures" of a *life* insurance company, he should only allow depreciation thereon to the extent that such "furniture and fixtures" were used in what he termed the "*Investment* Department" of the company's business; and that he should disallow any depreciation on the "furniture and fixtures" used in all the balance of the company's business, as, for example, in the actuarial, medical, legal, executive, underwriting, premium collecting, and policy issuing Departments of the company.

This new departure of the Commissioner was erroneous in three distinct particulars:

(1) He disregarded entirely the fact that *life* insurance companies were given a depreciation allowance on their "property", without regard to its use or employment in business;

(2) Disregarding that fact, he proceeded to treat *life* insurance companies on a far harsher basis than corporations generally were treated, and than insurance companies *other* than *life* companies were treated.

(3) The Commissioner thus completely *reversed* the Congressional provisions. Instead of giving *life* insurance companies a *more* favorable depreciation treatment than other corporations, he actually gave them a much *less* favorable treatment!

It was this departure by the Commissioner from his former practice that brought on the *Lafayette Life* and *Rockford Life* cases to challenge his changed method of allowing depreciation on "furniture and fixtures," although there had been no change in either the Revenue Acts or in the Commissioner's Regulations thereunder.

III. The Correct Application of § 203(a)(7) of the Revenue Act of 1928.

It is expressly stipulated that "a reasonable allowance for depreciation of petitioner's [Rockford Life] furniture and fixtures for the year 1929 was $1,783.02" (No. 722; R. 14). This STIPULATION OF FACT, which is binding on this Court, removes from controversy every possible question as to what constitutes a *"reasonable allowance* for depreciation of the furniture and fixtures" owned by the Rockford Life.

The only question open for consideration is whether under § 203(a)(7), providing for a reasonable allowance for the depreciation of the Rockford Life's "property," the Commissioner could arbitrarily sub-divide its "furniture and fixtures" into two classes, *i. e.,* (1) that which was used in what he terms the "investment" department and (2) that which was used in all other departments of the company; and then to allow depreciation on that used in the "investment" department, and to deny depreciation on all the balance.

There is nothing in the language of the statute, or in the legislative or administrative history to justify the Commissioner's action.

Congress has never given the slightest support to any such application of its plain and unambiguous language granting to life insurance companies a depreciation allowance on their "property."

The Commissioner's action in splitting up the "property" into two kinds, according to the *use* to which the "furniture and fixtures" were put, was wholly unjustified.

The B. T. A.'s established view on this question was

thus expressed in *Lafayette Life Insurance Company*, 26 B. T. A. 946, 951:

> "The last question raised by the respondent [Commissioner] is whether petitioner [Lafayette Life] is entitled to deductions for depreciation of furniture and fixtures used in the underwriting portion but not in the investment portion of its business. The provisions of the Revenue Act of 1926 which are applicable here are as follows:
>
> Sec. 244. (a) In the case of a life insurance company the term 'gross income' means the gross amount of income received during the taxable year from interest, dividends and rents. * * *
>
> Sec. 245 (a) In the case of a life insurance company the term 'net income' means the gross income less— * * *
>
> (7) A reasonable allowance for the exhaustion, wear and tear of property * * *.
>
> The respondent [Commissioner] contends that, as the statute confines petitioner's [Lafayette Life] gross taxable income to receipts of interest, dividends and rents, therefore, the deductible allowance for depreciation of property logically and properly includes only such property as petitioner [Lafayette Life] used in the production of its taxable income.
>
> In our opinion that contention is not well founded.
>
> In Regulations 69, construing the revenue act, the respondent [Commissioner] says, in Article 685(2), that 'The deduction allowed by § 245(a)(7)* for depreciation is identical* with that allowed other corporations by § 234(a)(7).' That limits the allowance for depreciation to the 'exhaustion, wear and tear of property used in the trade or business.' Unquestionably the trade or business of this petitioner [Lafayette Life] covered not only investments of its funds, but the writing and issuance of life insurance policies, collecting premiums, and the like. While

* [The B. T. A. did not comment on the facts that, after the 1921 Act, *the Regulations were in error* in saying that the depreciation deduction was *"identical"* for insurance companies and *other* corporations. Cf. (2) (3), pages 59, 60, 61, note, 62 (1) (2) (3), *supra.*]

there were two phases of petitioner's [Lafayette Life] activities, **the underwriting and the investment, the two combined constituted its business. Each was dependent upon and related to the other, and both were necessary factors for the success of the business.**

Had Congress desired to limit the depreciation allowance in the manner now urged by respondent [Commissioner], it would undoubtedly have so worded the statute. No such limitation is expressed, however, and we find nothing in the statute to indicate an intention to create such a restriction. In our opinion, therefore, the petitioner [Lafayette Life] is entitled to the amounts claimed by it for depreciation on its furniture and fixtures, namely, $788.88 for the year 1926 and $861.40 for the year 1927."

The C. C. A. (7th) based its reversal of the B. T. A. upon the erroneous assumption that a life insurance company was only taxed upon so-called "investment" income; and that, consequently, its *deductions* ought to be limited to those arising out of its "*investment*" business. (No. 722 R. 23; Cf. *Com'r* vs. *Lafayette Life*, 67 F. (2d) 209, 211).

To that argument we respond;

(1) We are applying a plain, unambiguous statute which contains nothing to justify an arbitrary "splitting up" of the objects to which the statute applies.

(2) For ten years, neither the Commissioner nor anyone else ever thought of "splitting up" the "property" to which the statute applied into a couple of arbitrary "classes", according to the use to which the "property" was put, *applying* the statute to one and *rejecting* it as to the other.

(3) The C. C. A.'s (7th) decision was based upon the erroneous assumption that a *life* insurance company has

an "investment" income that *is* taxed, and an "underwriting" income that is *not* taxed; whereas, Congress has *never* applied either the term "investment" or the term "underwriting" to a *life* insurance company, but it has authoritatively *defined* what constitutes *all* of the taxable *income* of a life insurance company.

A life insurance business is a homogeneous whole requiring, on the one hand, the collection of premiums from its policyholders for the sole purpose of investing and reinvesting them, so as to pay out of its assets (as a whole) the death claims of its policyholders as they respectively die, paid-up policies as they mature, surrender values when demanded, and then to return to the policyholders, in shape of annual dividends, any overpayments which policyholders have made in premiums, not necessary to be used for the payment of death losses, maturities, surrender values and expenses.

There is no justification for "splitting up" a mutual life insurance company into a so-called "investment" branch and an "underwriting" branch. Congress has never applied the terms "investment income" and "underwriting income" to a *life* insurance company. Those two expressions were first used by Congress in the Revenue Act of 1921, (continued in identic use in the subsequent Revenue Acts of 1924, 1926, 1928 and 1932), but in each of those Acts, those terms were expressly stated to be applicable to "every insurance company (*other than a life* or mutual insurance company)".* Therefore, when Congress in its only use of the terms "investment income" and "underwriting income", expressly provided that they *should not*

* See § 246 (a), (b) (3) (4) of the Revenue Acts of 1921, 1924, 1926, 42 Stat. 263, 43 Stat. 291, 44 Stat. 49; § 204 (a), (b) (3) (4) of the Revenue Acts of 1928 and 1932, 45 Stat. 844, 47 Stat. 226.

apply to a life insurance company, there is certainly no justification for the C. C. A. (7th) or for the Commissioner to fritter away the plain language of a statute applying to life insurance companies, by applying to them two phrases, which Congress expressly provided *should not apply* to life insurance companies.

(4) In its opinion in the *Lafayette Life* case, 67 F. (2d) 209, 211, the C. C. A. (7th) quotes the words, "reasonable allowance for obsolescence"; and asks the rhetorical question, "What significance has the word 'reasonable'?"

Whatever relevancy, if any, the provision for "obsolescence" may have had in the *Lafayette Life* case (and we are unable to perceive any relevancy there), it certainly has no sort of relevancy in the *Rockford Life* case, where no question of obsolescence was involved, and the word "obsolescence" does not even appear anywhere in the Record.

(5) The Commissioner both "determined" and "stipulated" that a "reasonable allowance" for depreciation of the Rockford Life's furniture and fixtures for 1929 was $1,783.02. That STIPULATION automatically eliminated any question as to the "reasonableness" of the amount so stipulated. "Reasonable allowance" for depreciation refers to the *basis* adopted to measure the depreciation. The necessary elements in computing depreciation are (1) the original cost of the asset, and (2) its probable lifetime. If the lifetime of a piece of property is (say) ten years, then an annual 10% depreciation rate, which would spread the cost over the entire ten-year lifetime, would seem to be "reasonable"; whereas, an annual 25% depreciation rate would be manifestly "*un*reasonable."

Again, in determining the "reasonable" amount of annual depreciation, there are several established methods for distributing the amount of the depreciation over the life of the asset and thus determining the annual amount of depreciation. It may be (*a*) a fixed annual percentage of the cost; or (*b*) an amount which decreases each year; or (*c*) ascertained by some periodical re-valuation; or (*d*) any one of several other well-known established methods. Each of these methods includes only (1) the initial cost, and (2) the lifetime of the asset, as the necessary factors in determining the "reasonable allowance" for depreciation. The word, "reasonable" refers to the rate of depreciation, or the amount of depreciation when determined by some established method, taken in connection with the cost of the property and its probable future lifetime. A "reasonable allowance" for depreciation, or a reasonable depreciation," **has no connection whatsoever with the taxpayer's "gross income," "net income" or any statutory definition of either.**

Although the Commissioner stipulated that $1,783.02 constituted a "reasonable allowance for depreciation" of the Rockford Life's furniture and fixtures for 1929, his *application* of the statute *took away* from the Rockford Life practically five-sixths of what the Commissioner *stipulated* was its reasonable allowance for depreciation for 1929.

The only method by which the decision of the C. C. A. (7th) can be sustained is (1) to disregard Congress's *un*qualified use of the word "property"; (2) to *qualify* "property" by adding to it a phrase *not* used by Congress, *i. e.* only such property as is used by the company in its "investment" business; but without any statutory or

other guide to define the "investment" part of the business; and (3) to arrive at the qualification just mentioned, not by anything expressed in the Statute, but by an *unjustified assumption* that Congress had omitted from taxation one part of the company's income, and taxed only another part of the income; and then, on top of that erroneous assumption, to pile another erroneous assumption *i. e.*, that Congress *never intended to allow depreciation* upon such part of the company's property as was used in the production of the (*erroneously assumed*) untaxed portion of income.

If any such unauthorized method can be used to determine the meaning of a statute, then there is no limit to the possible interpretations that can be put upon a simple, well understood English sentence which for many years had been construed and applied without any difficulty.

Conclusion.

The judgment of the C. C. A. (6th) in No. 689, *Independent Life* case should be *affirmed*.

The judgment of the C. C. A. (7th) in the *Rockford Life* case should be *reversed*.

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April 2, 1934.